

SCOMM

107:1

FOR IMMEDIATE RELEASE

FEBRUARY 18, 1998

ECONOMIC DEVELOPMENT COMMITTEE

CONTACT: REPRESENTATIVE JERRY SANDERS, CHAIR
465-4945

ECONOMIC DEVELOPMENT
FUEL COSTS AND THE EFFECT ON THE ECONOMY

THE ECONOMIC DEVELOPMENT COMMITTEE WILL HOLD A HEARING AT THE CAPITOL BUILDING, ROOM 17, TUESDAY, FEBRUARY 24, 1998 AT 2:00 P.M. THE PURPOSE OF THE MEETING WILL BE TO LOOK INTO THE EFFECT OF HIGH FUEL COSTS ON ECONOMIC DEVELOPMENT IN ALASKA. TELECONFERENCES WILL BE HELD AT THE LEGISLATIVE INFORMATION OFFICES.

RECENT NEWS ARTICLES ON GAS PRICES GOING BELOW \$1 PER GALLON ELSEWHERE IN THE COUNTRY HAS GENERATED INTEREST AS TO WHY ALASKA PRICES HAVE NOT REFLECTED THE SAME SIGNIFICANT DECREASE. INDUSTRY LEADERS AND CONSTITUENTS HAVE SHOWN CONCERN ABOUT FUEL PRICES AND THE EFFECTS THEY HAVE ON THE ALASKAN ECONOMY. REPRESENTATIVE SANDERS, CHAIRMAN OF THE ECONOMIC DEVELOPMENT COMMITTEE, HAS CALLED THE MEETING TO FIND OUT:

1. ARE THE ALASKA PRICES OUT OF LINE WITH THE OTHER 49 STATES?
2. IF SO, WHY?
3. WHAT EFFECT DOES THIS HAVE ON ECONOMIC DEVELOPMENT IN ALASKA?
4. WHAT, IF ANYTHING, THE LEGISLATURE CAN DO TO INFLUENCE PRICES?

===

California gas price hits 99.9¢

The Associated Press

LOS ANGELES — A worldwide oil glut and fierce competition among retailers have pushed gasoline prices below \$1 per gallon at some Southern California stations, yielding a windfall for motorists while pinching dealers' profits.

Prices for unleaded regular at self-serve pumps dropped to 99.9 cents per gallon at some stations this week as a nationwide price slide reached the region, the nation's biggest gasoline market.

"Your prices have been way out of line for about three months. It's catching up to you," William Berman of the Pump Price Report newsletter said Friday.

Stations offering gasoline at or near the dollar mark were attracting motorists in Los Angeles and Orange counties on Friday. Station operations priced above the competition prepared to make cuts to stay competitive.

Julie Peak, who operates an Arco station in the Granada Hills area of Los Angeles, was keeping busy Friday with her pumps set at \$1.01.9, but expected Arco to order her to cut the price to 99.9 cents by Friday night or this morning. Some stations in her area, including one just a few blocks away, were turning away customers with prices already at 99.9 cents, she said.

SAY it isn't so.

"My friends went to them. I said, 'It's only 2 cents. It's not that big a difference,'" an exasperated Peak said. "When it's 99 cents, people go crazy."

California prices still are higher than in some parts of the country. According to the Oil & Gas Journal's most recent survey, taken on Feb. 4, Oklahoma City stations were selling gasoline for as little as 90.3 cents per gallon. In Atlanta, the price was 90.7 cents and Detroit, 97.6 cents.

Nationally, the average price of unleaded regular has fallen 7 cents to \$1.14 since the beginning of the year, said Trilby Lundberg, publisher of the biweekly Lundberg Survey, which checks prices at 10,000 gasoline stations nationwide.

Prices typically are higher in California because of high state taxes and strict clean air regulations that require more expensive, cleaner burning blends of gasoline.

Motorists who buy the cheap gas are benefiting from several factors, including a worldwide oversupply of crude oil that has been pushing prices down for weeks across the nation.

The glut is due in part to increased production by the 11-nation Organization of Petroleum Exporting Countries. It also is partially a result of the financial crisis in Asia where demand has dropped sharply in recent weeks.

- a constituent
who was
visiting
Two Weeks
ago. Said
it was 87¢

Appendix B

Comparison of Highway Gasoline Tax Rates

October 1997

State	Rate (\$ per gallon)	Other Tax ⁽¹⁾ (\$ per gallon)	Total (\$ per gallon)	Rank
Alabama	16	4.1	20.1	30
ALASKA	8	0	8	50
Arizona	18	1	19	37
Arkansas	18.5	0.2	18.7	40
California	18	10.0	28	6
Colorado	22	0	22	23
Connecticut	36	4.3	40.3	1
Delaware	23	0	23	18
Florida	12.8	9.8	22.6	22
Georgia	7.5	4.3	11.8	48
Hawaii	16	19.6	35.6	2
Idaho	25	0	25	14
Illinois	19	6.8	25.8	10
Indiana	15	4.4	19.4	36
Iowa	20	1	21	28
Kansas	18	1	19	37
Kentucky	15	1.4	16.4	46
Louisiana	20	0	20	31
Maine	19	0	19	37
Maryland	23.5	0	23.5	17
Massachusetts	21.5	0	21.5	26
Michigan	19	6.8	25.8	10
Minnesota	20	2	22	23
Mississippi	18	2.4	20.4	29
Missouri	17	0	17	43
Montana	27	0.8	27.8	7
Nebraska	24.5	0.8	25.3	13
Nevada	23	10.3	33.3	3
New Hampshire	18	1.7	19.7	35
New Jersey	10.5	4	14.5	47
New Mexico	17	1	18	42

New York	8	22.4	30.4	4
North Carolina	22.6	0.3	22.9	21
North Dakota	20	0	20	31
Ohio	22	0	22	23
Oklahoma	16	1	17	43
Oregon	24	0	24	16
Pennsylvania	12	14.8	26.8	8
Rhode Island	28	1	29	5
South Carolina	16	0.8	16.8	45
South Dakota	21	2	23	18
Tennessee	20	1.4	21.4	27
Texas	20	0	20	31
Utah	24	0.5	24.5	15
Vermont	19	1	20	31
Virginia	17.5	0.8	18.3	41
Washington	23	0	23	18
West Virginia	20.5	4.9	25.4	12
Wisconsin	23.8	3	26.8	8
Wyoming	9	0	9	49
Federal	18.3	N/A	18.3	N/A
U.S. Average*	17.8	4.8	22.6	N/A

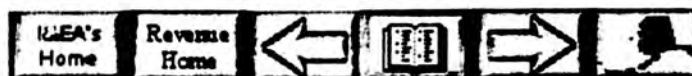
(1) Includes state sales tax, gross receipts tax and underground storage tank taxes.

State sales taxes are based on selected city average retail gasoline prices as of August 22, 1997.

* Weighted average

SOURCE: American Petroleum Institute, *A Summary of Nationwide and State-by-State*

Motor Fuel Taxes as of September 1997.



Archives

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No comments

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No comments

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No comments

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No comments

Tuesday, December 2, 1997

Gasoline prices drop - elsewhere

Last modified at 3:09 p.m. on Tuesday, December 2, 1997

By MARK SABBATINI
THE JUNEAU EMPIRE

Gas prices have declined nationally during the past two months and local wholesalers say they are paying less, but the difference isn't showing up at the pump.

The reason, officials said, is somebody is making more money.

The average price for a gallon of self-serve regular unleaded at Juneau's nine gas stations was \$1.4478 on Monday, with stations' prices largely unchanged in recent months. A national survey of 10,000 stations revealed an average price of \$1.1953 about 10 days ago, down from \$1.2742 on Sept. 5, said Trilby Lundberg, owner of Lundberg Survey in Camarillo, Calif.

"I would not be surprised if prices in most cities and the national average falls again because crude oil has slipped" following an agreement by OPEC to boost production, she said today.

Local officials agree Juneau's prices are based on "what the market will bear," although there is disagreement about who is profiting from the decrease in prices. One official said service station operators may be recovering money lost during an earlier price hike, while another said the money may be going to out-of-state corporate offices that control prices.

Prices at other stations in Alaska are also generally not reflecting the national decrease.

Dick Bevins, marketing manager for Petro Marine Services in Southeast Alaska, said his company's wholesale prices have dropped at least a nickel. He said some service stations may not be lowering their prices now because they remained relatively stable during a summer wholesale price increase.

A little
more
info
you
may have
missed.

"You can almost see what service station dealers are feeding their families when," he said. "Sometimes it was steak, sometimes it was hot dogs."

A June survey by the Empire found gas prices between \$1.42 and \$1.46 a gallon. Prices rose a few cents in August - a temporary increase at some stations - with current prices between \$1.42 and \$1.48 a gallon.

Bevens said some Seattle gas stations experienced fluctuations as high as 20 cents a gallon.

Some local service stations may be paying the same amount for their gas despite the price drop, said Jeff Hansen, manager of Taku Oil.

He said his company's buying price has dropped 8 cents a gallon during the past two months. But while the gas goes directly from Taku Oil's tanks to three local Union 76 stations, he said Phoenix-based TOSCO Corp. gets to buy the gas and resell it to the stations at whatever price it sets.

"We've seen over time the large companies like Unocal (whose retail operations were purchased by TOSCO) or Chevron in the past will set prices in a town according to what the market's doing," he said. "That's not unusual anywhere."

TOSCO officials did not return phone calls seeking comment this morning.

Eric Hansen, manager of De Hart's Auke Bay Store, said it actually costs him 6 cents a gallon more to buy gas now from his supplier, Delta Western, than it did two months ago. But he said his price of \$1.43 a gallon hasn't changed because "I pretty much stay competitive with our competitors down the road."

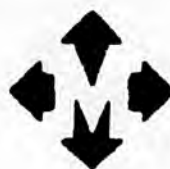
Mapco Express is generally cited by officials as setting the trend for local prices. Juneau prices dropped by up to 25 cents a gallon when they first opened a store in 1994, although prices have crept up since.

There appear to have been few price drops in other Alaska cities in recent months.

Cascade Convenience Center in Sitka is charging \$1.62, below the price in a June survey but 6 cents higher than two months ago, said Paul Kerber, a Petro Marine employee. A Ketchikan's station's price has increased 6 cents a gallon to \$1.62 since June and an Anchorage station remained even at \$1.30.

The exception is Fairbanks where some prices have fallen by 10 cents or more a gallon, to below \$1.30 a gallon, because of a recent Mapco opening.

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Comments or questions? Contact the Webmaster.



MAPCO ALASKA PETROLEUM INC.

Jeffrey J. Cook
VICE PRESIDENT
EXTERNAL AFFAIRS & ADMINISTRATION

April 2, 1998

Senator Frank H. Murkowski
UNITED STATES SENATE
322 Hart Senate Office Building
Washington, D.C. 20510-0202

Via Fax through Andrew Lundquist to (202) 224-4068

Dear Senator Murkowski:

There have been several articles in the Alaska newspapers since your press conference of March 27, 1998, at which you expressed concerns about gasoline prices in Alaska. We would have preferred to provide information and answers to some of your questions prior to the news conference, but I will take this opportunity to respond on behalf of MAPCO.

First, I need to note that crude oil is not the only component or cost involved with refining gasoline. Crude cost accounts for less than half of the retail price of gasoline. MAPCO and other Alaska refiners pay fair market value for the crude we purchase and we pay a pro-rated tariff to get it to our refinery. For one of our crude contracts with the State of Alaska, MAPCO pays a \$.15 per barrel premium for the crude oil.

The other costs of refining product in Alaska are all higher than at lower 48 refineries. Electricity is an ingredient of refining and we pay several million dollars per year to GVEA for electricity. We pay twice the cost for electricity here compared to our Memphis refinery. And electricity costs are two to three times higher here than for refineries in the Pacific Northwest. The chemicals, fuel, labor and transportation components of refining and distributing our refined product are all considerably higher here than in the lower 48 states. The average rate of pay at our North Pole Refinery is about \$10.00 per hour higher than for comparable positions at our Memphis refinery. This is a 50% higher cost for labor at our Alaska refinery. Alaska has some of the most stringent environmental standards that impact costs at the refining, wholesale and retail levels. In addition, MAPCO paid a \$30 million quality bank penalty in 1997 for the 600 million gallons of refined product sold, which equates to \$.05 per gallon. Or you can look at the quality bank penalty as adding \$2.10 to the cost of each barrel of crude we refine. The \$70 million jet fuel expansion we are currently doing at our refinery would cost in the \$45 to \$50 million range in Memphis. So it follows that refined product prices will also be higher in Alaska than elsewhere in the Country.

But the prices in Alaska are much lower than they would be without the presence of the Alaska refiners. When I left for college at the University of Oregon driving down the Alcan Highway with Jim Dodson in the fall of 1963, the price of gasoline in Fairbanks was around \$.55 per gallon. We arrived in Eugene, Oregon, and paid about \$.26 per gallon. It was after 1969 when Tesoro started refining in Alaska that prices dropped. In 1978 gasoline was \$.859 in Fairbanks

and it was \$.609 in Eugene. The per cent age price difference had dropped considerably by 1978. MAPCO started refining gasoline in 1985 and prices dropped again. Today the price of gasoline in Fairbanks is \$1.209 and in Eugene, Oregon it is \$1.109. The gap has narrowed considerably. I should note that today the price of the Fairbanks Daily News-Miner is \$.75 and the cost of the Eugene Register Guard is \$.50. The news paper here costs 50% more than in Eugene, while the gasoline is only 9% more in Fairbanks.

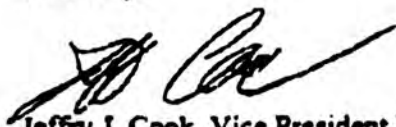
I also wanted to point out that some of the data you used in analyzing gasoline prices was not correct as pertains to the Fairbanks and Anchorage markets. The data provided to you by AAA appeared to show a price of \$1.269 for Alaska. The Fairbanks price is \$1.209 and the Anchorage price is about \$1.159. So the after tax price of Alaska gasoline is in the \$.89 to \$.94 per gallon range as opposed to \$1.00 per gallon. The price of gasoline in the bush areas is really not relevant to the analysis in my opinion since they can only receive fuel once or twice a year in relatively small volumes.

MAPCO is proud of our refining activity and the positive influence we have had on fuel prices over the 20 years we have operated at our North Pole Refinery. We are proud that in 1998 we supported 688 Alaskan vendors with \$450 million in spending. We spent more with everyone of those vendors than we would have for comparable goods or services in the lower 48 States. But that is a fact of life in Alaska. Our presence here means that \$450 million multiplies around the Alaska economy a number of times and helps thousands of Alaskans directly or indirectly. As an example, we pay approximately \$1.8 million in property taxes that are shared between the Fairbanks North Star Borough and the City of North Pole. Our refining and retail operations employ about 500 Alaskans with a total for payroll and benefits of approximately \$20 million per year. This payroll amount is in addition to the total paid to vendors in 1997.

Earlier this week I provided Andrew Lundquist with three graphs showing that our price of gasoline, jet fuel and diesel fuel have fallen as fast, and in some cases faster, than crude oil prices have fallen. We feel we have been very fair and sensitive to the Alaskan consumer, and we pledge to maintain that sensitivity and fairness in the future.

Please let me know if I can answer questions or provide clarification on the issue of gasoline and other fuel prices in Alaska.

Sincerely,



Jeffrey J. Cook, Vice President External Affairs
MAPCO ALASKA PETROLEUM Inc.



MAPCO ALASKA PETROLEUM Inc.



Official Business

COMMITTEES:
Labor and Commerce
Transportation

Alaska State Legislature

Chairman - Economic Development Committee

REPRESENTATIVE
JERRY SANDERS
District 19

Anchorage
716 W. 4th Ave.
Anchorage, AK 99501
(907) 258-8199

State Capitol
Juneau, AK 99801-1182
(907) 465-4945

HOUSE SPECIAL COMMITTEE ON ECONOMIC DEVELOPMENT

"Fuel Costs and The Effect on Economic Development"

April 23, 1998
3:00 p.m.

Retail Prices as of March 16, 1998 – Crude based on \$12.60 per barrel

	Anchorage	Juneau	Fairbanks	California
Crude	1.179	1.349	1.259	1.069
	<u>.30</u>	<u>.30</u>	<u>.30</u>	<u>.30</u>
	.879	1.049	.959	.769
State Tax	<u>.08</u>	<u>.08</u>	<u>.08</u>	<u>.28</u>
	.799	.969	.879	.489
Federal Tax	<u>.18</u>	<u>.18</u>	<u>.18</u>	<u>.18</u>
	.619	.789	.699	.309
Dealer Markup	<u>.20</u>	<u>.20</u>	<u>.20</u>	<u>.13</u>
Refining & Distr.	.419	.589	.499	.179

1. If Alaska's refinery portion of this chart were only double we would not be holding these investigations.
2. Why would fuel refined in Fairbanks be shipped to Anchorage at a cost of \$.06 to \$.10 and sold for \$.08 less?
3. Why does Tesoro, who has 39% of the Alaskan market, ship product to the west coast where it brings a return of \$.18 minus shipping charges instead of selling it in Alaska for \$.40 or so?

Sec. 38.05.183. Sale of royalty.

(a) The sale, exchange or other disposal of a mineral obtained by the state as a royalty under AS 38.05.182, or the sale, exchange or other disposal in whole or in part of a right to receive future mineral production under a state lease under this chapter, shall be by competitive bid and the sale, exchange or other disposal made to the highest responsible bidder, except that competitive bidding is not required when the commissioner, after prior written notice to the Alaska Royalty Oil and Gas Development Advisory Board under AS 38.06.050, determines that the best interest of the state does not require it or that no competition exists.

(b) When competitive bids are required, the commissioner, after prior written notice to the Alaska Royalty Oil and Gas Development Advisory Board, may reject all bids on a determination that because of the amount of the bids, the lack of responsibility on the part of the bidders, or for reasons consistent with the criteria set out in AS 38.06.070, the acceptance of the bids would not be in the best interest of the state.

(c) If the commissioner determines that a sale, exchange or other disposal of a mineral obtained by the state as a royalty under AS 38.05.182 or of a right to receive future mineral production under a state lease under this chapter shall be made otherwise than by competitive bid, and the Alaska Royalty Oil and Gas Development Advisory Board has been notified in writing of that determination, the commissioner shall make public in writing the specific findings and conclusions upon which that determination is based.

(d) Oil or gas taken in kind by the state as its royalty share may not be sold or otherwise disposed of for export from the state until the commissioner determines that the royalty-in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs. The commissioner shall make public, in writing, the specific findings and reasons on which the determination is based.

(e) When a sale, exchange or other disposal of oil or gas taken in kind by the state as its royalty share, or a sale, exchange or other disposal in whole or in part of a right to receive future royalty oil or gas, under a state lease under this chapter is made other than by competitive bid, the sale, exchange or other disposal shall be awarded by the commissioner to the prospective buyer whose proposal offers the maximum benefits to citizens of the state. **The commissioner shall consider**

(1) the cash value offered;

(2) the projected effects of the sale, exchange or other disposal on the economy of the state;

(3) the projected benefits of refining or processing the oil or gas in the state;

(4) the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the state with price or supply benefits to the citizens of the state; and

(5) the criteria listed in AS 38.06.070 (a).

Sec. 38.06.070. Criteria.

(a) In the exercise of its powers under AS 38.06.040 (a) and 38.06.050 the board shall 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 and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;
- (3) the desirability of localized capital investment, increased payroll, secondary development and other possible effects of the sale, exchange or other disposition of oil and gas or both;
- (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 transaction;
- (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 and negative environmental effects related to the transaction; and
- (8) the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

(b) When it is economically feasible and in the public interest, the board may recommend to the commissioner of natural resources, as a condition of the sale of oil or gas obtained by the state as royalty, that

- (1) the oil or gas be refined or processed in the state;
- (2) the purchaser be a refiner who supplies products to the Alaska market with price or supply benefits to state citizens; or**
- (3) the purchaser construct a processing or refining facility in the state.

(c) The board shall make a full report to the legislature on each criterion specified in (a) or (b) of this section for any disposition of royalty oil or gas that requires legislative approval. The board's report shall be submitted for legislative review at the time a bill for legislative approval of a proposed disposition of royalty oil or gas is introduced in the legislature.



NEWS RELEASE

SUBJECT:

1-800-332-6119 ext. 8130

FOR RELEASE:

TODAY'S DATE:

CONTACT:

February 20, 1998

Memo

TO: Mike

FROM Sue Akey

here is some history - let me know if you need more information. 1-800-332-6119 EXT 8130

Date	<i>2 Sta</i> Anchorage	<i>6 Sta.</i> Alaska Average	<i>321 Sta</i> National AVE
Feb 98	1.199	1.327	1.114
Dec. 97	1.279	1.354	1.215
Aug. 97	1.349	1.415	1.263
July 97	1.315	1.395	1.232
June 97	1.349	1.391	1.253
May 97	1.329	1.402	1.242
Apr 97	1.329	1.402	1.253
Jan. 97	1.304	1.347	1.271

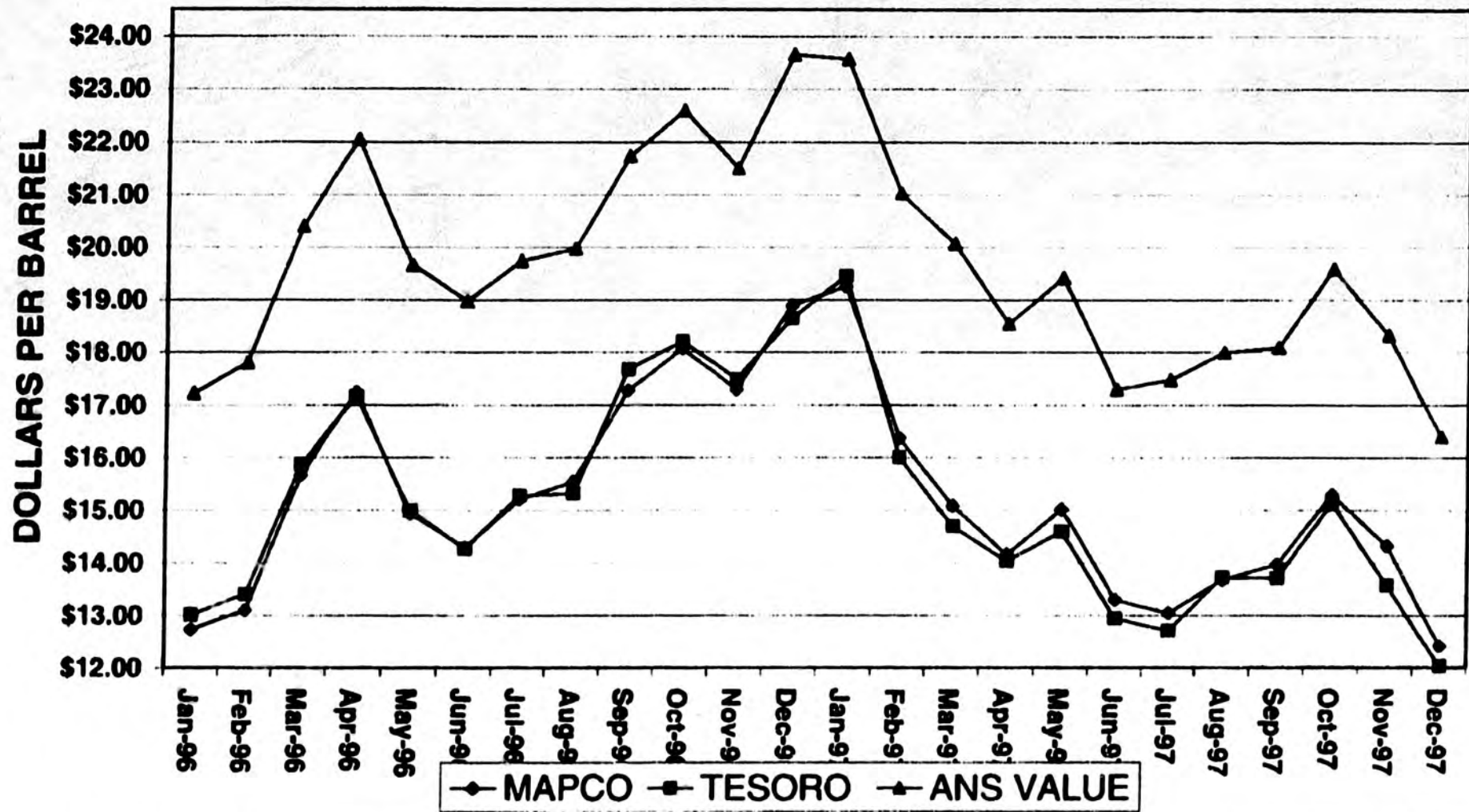
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ROYALTY IN KIND PER BARREL PRICE For the Two Years Ended December 31, 1997

P.03



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00:22 8661-11-234

ROYALTY IN KIND PER BARREL PRICE **For the Two Years Ended December 31, 1997**

MONTH	PER BARREL PRICE				AVG MONTHLY ANS VALUE PER PLATTS
	MAPCO	REVISE DATE	TESORO	REVISE DATE	
Jan-96	\$12.73240	8/1/97	\$13.01364	6/30/97	\$17.2271
Feb-96	\$13.09963	7/1/97	\$13.41086	6/3/96	\$17.8000
Mar-96	\$15.66164	7/1/97	\$15.85007	7/1/96	\$20.3971
Apr-96	\$17.23502	7/1/97	\$17.16655	8/1/96	\$22.0424
May-96	\$14.93315	7/1/97	\$14.99082	3/3/97	\$19.6550
Jun-96	\$14.28763	7/1/97	\$14.26562	10/1/96	\$18.9780
Jul-96	\$15.19824	7/1/97	\$15.27400	11/1/96	\$19.7429
Aug-96	\$15.54208	7/1/97	\$15.31424	12/2/96	\$19.9705
Sep-96	\$17.26905	7/1/97	\$17.66870	1/7/97	\$21.7305
Oct-96	\$18.06795	7/1/97	\$18.20691	2/3/97	\$22.5952
Nov-96	\$17.28787	7/1/97	\$17.48580	3/3/97	\$21.5000
Dec-96	\$18.89376	7/1/97	\$18.64901	3/3/97	\$23.6576
Jan-97	\$19.25196	12/2/97	\$19.44604	4/1/97	\$23.5686
Feb-97	\$16.36837	12/2/97	\$16.01334	5/1/97	\$21.0247
Mar-97	\$15.07830	12/2/97	\$14.69376	6/2/97	\$20.0860
Apr-97	\$14.15840	12/2/97	\$14.03689	7/1/97	\$18.5427
May-97	\$15.02068	12/2/97	\$14.59313	8/1/97	\$19.4138
Jun-97	\$13.30065	12/2/97	\$12.94453	9/2/97	\$17.2971
Jul-97	\$13.04149	12/2/97	\$12.70353	10/1/97	\$17.4773
Aug-97	\$13.67822	12/2/97	\$13.72986	11/3/97	\$17.9848
Sep-97	\$13.96846	1/2/98	\$13.71214	2/2/98	\$18.0867
Oct-97	\$15.29256	2/2/98	\$15.13235	1/2/98	\$19.5857
Nov-97	\$14.32151	1/2/98	\$13.57867	2/5/98	\$18.3211
Dec-97	\$12.40562	2/2/98	\$12.02909	2/2/98	\$16.3918

PREPARED BY J. STOUFFER, DIV OF OIL GAS

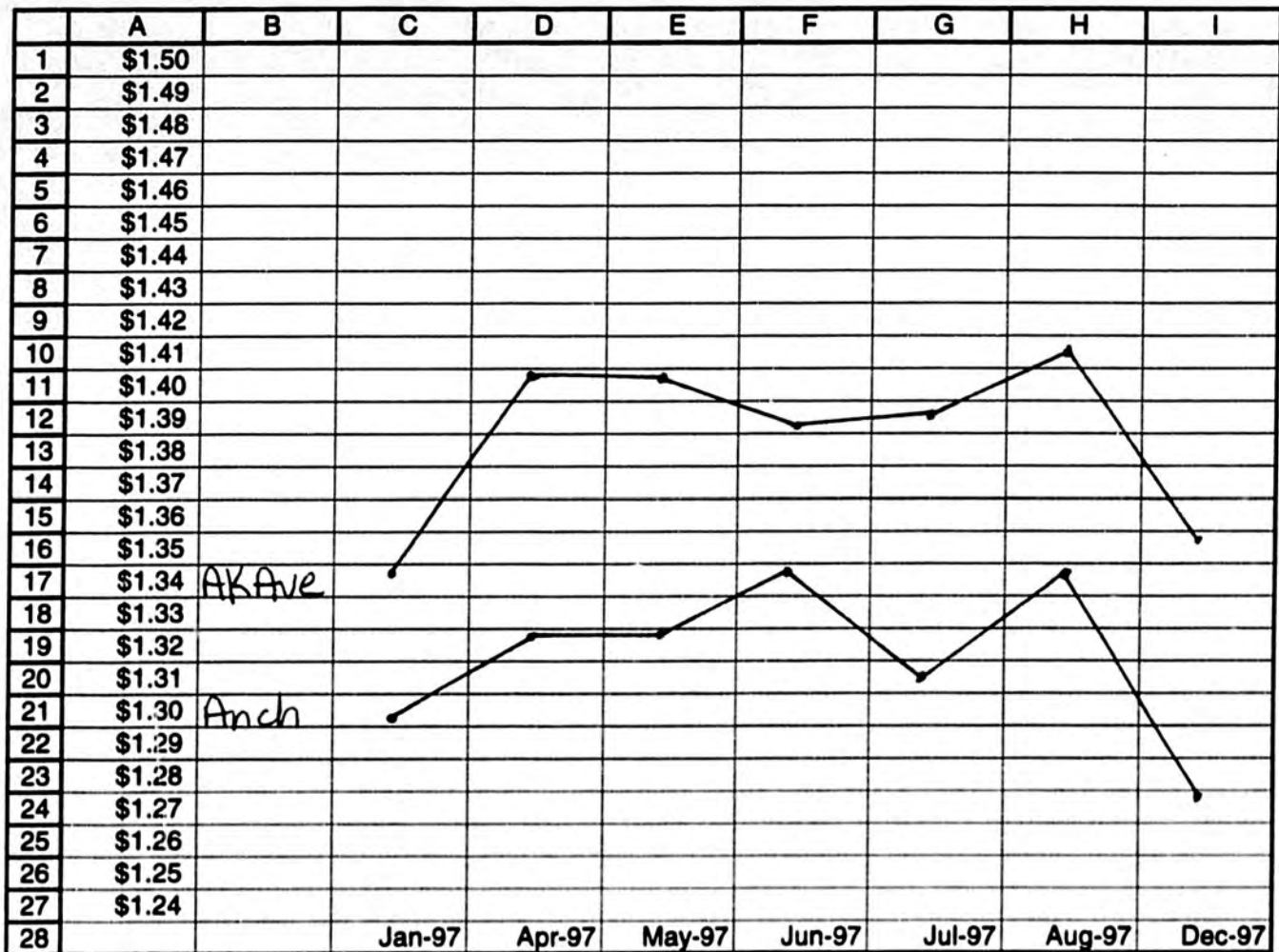
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2/24/98

Figures provided by AAA Alaska 2/20/98

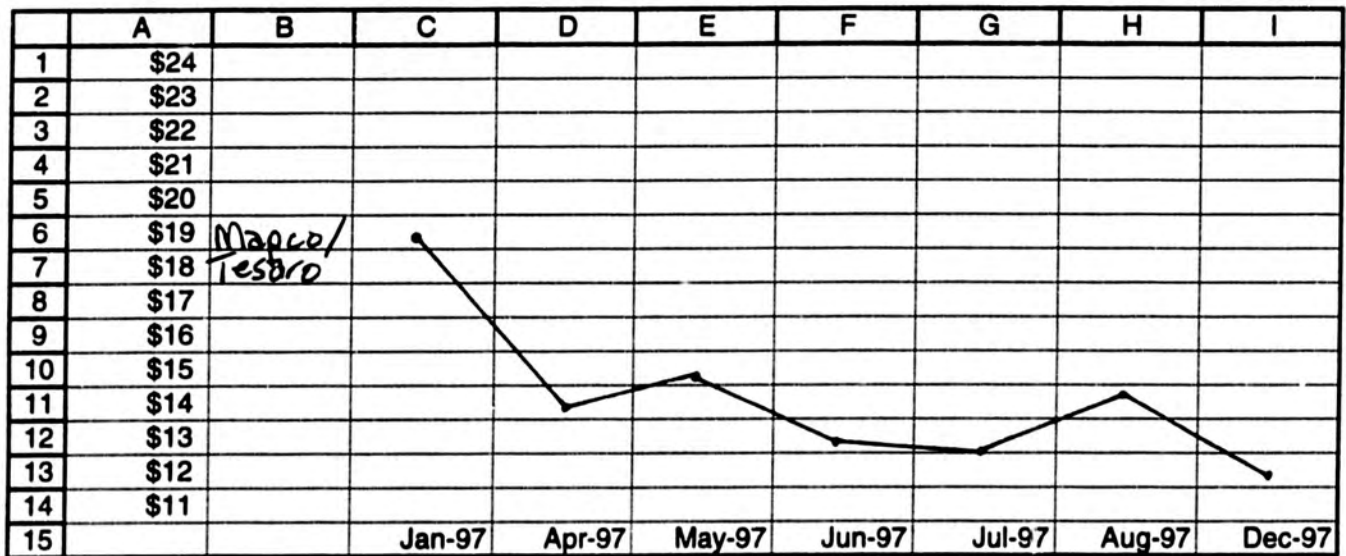
Anch. = Anchorage Average

AK Aver. = Alaska Average



Royalty in Kind Per Barrel Price
 January 1997 - Dec. 1997
 Prepared by J. Stouffer, Div of Oil Gas

Dollars per barrel



Appendix B

Comparison of Highway Gasoline Tax Rates

October 1997

State	Rate (¢ per gallon)	Other Tax ⁽¹⁾ (¢ per gallon)	Total (¢ per gallon)	Rank
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Colorado	22	0	22	23
Connecticut	36	4.3	40.3	1
Delaware	23	0	23	18
Florida	12.8	9.8	22.6	22
Georgia	7.5	4.3	11.8	48
Hawaii	16	19.6	35.6	2
Idaho	25	0	25	14
Illinois	19	6.8	25.8	10
Indiana	15	4.4	19.4	36
Iowa	20	1	21	28
Kansas	18	1	19	37
Kentucky	15	1.4	16.4	46
Louisiana	20	0	20	31
Maine	19	0	19	37
Maryland	23.5	0	23.5	17
Massachusetts	21.5	0	21.5	26
Michigan	19	6.8	25.8	10
Minnesota	20	2	22	23
Mississippi	18	2.4	20.4	29
Missouri	17	0	17	43
Montana	27	0.8	27.8	7
Nebraska	24.5	0.8	25.3	13
Nevada	23	10.3	33.3	3
New Hampshire	18	1.7	19.7	35
New Jersey	10.5	4	14.5	47
New Mexico	17	1	18	42

New York	8	22.4	30.4	4
North Carolina	22.6	0.3	22.9	21
North Dakota	20	0	20	31
Ohio	22	0	22	23
Oklahoma	16	1	17	43
Oregon	24	0	24	16
Pennsylvania	12	14.8	26.8	8
Rhode Island	28	1	29	5
South Carolina	16	0.8	16.8	45
South Dakota	21	2	23	18
Tennessee	20	1.4	21.4	27
Texas	20	0	20	31
Utah	24	0.5	24.5	15
Vermont	19	1	20	31
Virginia	17.5	0.8	18.3	41
Washington	23	0	23	18
West Virginia	20.5	4.9	25.4	12
Wisconsin	23.8	3	26.8	8
Wyoming	9	0	9	49
Federal	18.3	N/A	18.3	N/A
U.S. Average*	17.8	4.8	22.6	N/A

(1) Includes state sales tax, gross receipts tax and underground storage tank taxes.

State sales taxes are based on selected city average retail gasoline prices as of August 22, 1997.

* Weighted average

SOURCE: American Petroleum Institute, *A Summary of Nationwide and State-by-State Motor Fuel Taxes as of September 1997*.



Feb 20, 98

Alaska Self-Service Gas Prices			
City	Regular	Premium	Station
Anchorage	1.259	1.479	272 7210
Anchorage	1.199	1.399	279 5226
Juneau	1.449	1.599	789-2880
Juneau	1.439	1.589	789 9476
Fairbanks	1.329	1.449 1.519	456 4224
Fairbanks	1.289	1.489	452 8839
State Average			



Fuel News

Gas Prices Tumble To Lowest Level Since 1994, AAA Says

ORLANDO, Fla., Feb. 17, 1998 — The national average price of gasoline fell 4.5 cents in one month to reach its lowest point since spring of 1994, according to AAA.

AAA's monthly Fuel Gauge Report shows the average price of self-serve regular unleaded gasoline is \$1.114 per gallon, 17.3 cents less than one year ago.

In the last five months, the price has fallen 17.4 cents to reach the lowest level since May 1994 when the price was \$1.105 per gallon.

The average price of self-serve mid-grade unleaded is \$1.209 per gallon, 3.2 cents less than last month and 15.7 cents less than one year ago. Self-serve premium is \$1.262, down 4.5 cents from a month ago and 17.4 cents less than last year.

Self-serve regular unleaded is most expensive in the West at \$1.245 per gallon, 6.9 cents less than last month and 12.1 less than a year ago. It is least expensive in the Southeast at \$1.039, 3.9 cent less than a month ago and 17.6 cents less than last year.

Other regional prices for self-serve are: New England, \$1.159 per gallon, down 4.7 cents in one month and down 16.8 cents from last year; Mid-Atlantic, \$1.113, down 4.3 from the previous month and 19.8 cents less than a year ago; Great Lakes, \$1.057, 1.7 cents less than last month and 20.6 cents less than last year; Midwest, \$1.049, 3.6 cents less than last month and down 21.7 cents from a year ago; and Southwest, \$1.096, down 4.8 cents in one month and 16.4 cents less than last year.

The national average prices for self-serve regular unleaded gasoline for the last six months were: January, \$1.159 per gallon; December, \$1.216; November, \$1.234; October, \$1.264; September, \$1.288; and August, \$1.264.

The national average prices for self-serve regular unleaded gasoline in February for the last five years were: 1997, \$1.287 per gallon; 1996, \$1.129 gallon; 1995, \$1.118; 1994, \$1.069; 1993, \$1.093; and 1992, \$1.049.

Motor Gasoline Watch

US Department of Energy, Energy Information Administration

Contact Robert Schmer

202-586-4522

rschmer@eia.doe.gov

Motor Gasoline Watch

February 11, 1998

SUPPLY

- Stable demand along with higher production contributed to an increase in stocks last week. Total gasoline stocks ended the week at 220.6 million barrels. Reformulated gasoline stocks were down 0.5 million barrels last week. Finished gasoline production averaged 7.8 million barrels per day last week, an increase of 236 thousand barrels per day from production during the prior week. Finished gasoline imports were 206 thousand barrels per day compared to 326 thousand barrels per day during the prior week.
- Total motor gasoline stocks at the primary storage level were 13.0 million barrels above the level for the same week last year. Imports of total gasoline averaged 373 thousand barrels per day of which 85 thousand barrels per day were reformulated.

● Gasoline Supply Tables

PRICES

- With much of the effect of a possible strike against Iraq already factored-in, gasoline spot prices ended the week slightly lower, mainly driven by API's report of a large gasoline stock build for the week ending January 30, 1998. Prices also responded to reports of European cargos steaming toward the United States. The spot price for conventional gasoline in the New York Harbor ended at 45.03 cents per gallon on February 9, 1998, down 4.48 cents from last week, and well below the price from a year ago. Declining demand, attributed to bad weather, further depressed product prices on the West Coast.
- The national retail gasoline price was 105.3 cents per gallon on February 9, 1998, down 0.8 cent since last week and 18.1 cents per gallon since last year. Prices have lost 19.1 cents since the end of August peak and now rival levels recorded in May 1994.

● Gasoline Prices Tables

Tuesday, February 3, 1998

Juneau pump prices perplexing

Last modified at 2:27 p.m. on Tuesday, February 3, 1998

By MARK SABBATINI
THE JUNEAU EMPIRE

Cliff Ouellette says local gas prices are about what he remembers when he departed for a temporary job in Washington a few months ago. But he says prices there are a different story.

"Right before I left they were \$1.05 (a gallon)," the house frame builder said. "They went down quite a bit. They were \$1.32 when I first got there."

Juneau gas prices dropped by a couple of cents a gallon recently, the first change in months, but the decrease falls well short of a 17-cent drop in the nationwide average since last September. The gap between Juneau's prices and the national average is about 35 cents, compared to 20 cents in September and 15 cents just over a year ago.

Local prices Monday for regular unleaded ranged from \$1.40 to \$1.47 a gallon, while premium unleaded ranged from \$1.55 to \$1.66 a gallon.

A gallon of regular unleaded cost \$1.44 cents Monday at the Airport Union 76 station. The price was \$1.47 last September, \$1.44 last June and \$1.40 in December of 1996.

The nationwide average for self-serve regular unleaded on Jan. 23 was \$1.10 a gallon, said Trilby Lundberg, owner of Lundberg Survey in Camarillo, Calif. The average was \$1.27 last September, \$1.22 last June and \$1.25 in December of 1996.

She said some stations around the country appear to have bottomed out, but she still expects a further drop in the national average when she conducts another survey this weekend.

"It's just the low-demand season for gasoline," Lundberg said. Also, she said, crude oil prices have plummeted worldwide in recent months.

Juneau's prices are at, or just above, the average of cities such as San Francisco and Reno, she said.

Local officials have said the trend in Juneau gas prices is generally set by Mapco Express, with competitors dropping prices up to 25 cents a gallon when the station opened in 1994. Prices have generally crept up ever since, although Mapco spokesman Jeff Cook declined to discuss the specific reasons for the increases during the past 14 months.

``It's just market factors," he said.

Employees at the Fisherman's Bend station in Auke Bay said there has been a slight decrease in wholesale prices recently, but the station would not have reduced its pump prices if Mapco had not done so. Manager Glen Lewis said the drop in his wholesale prices has not matched the retail drop nationwide, citing freight costs and lower volume purchasing as factors. He also said gas sales are not as profitable in the winter because people don't buy as much.

``No way are we getting fat off the gas," he said.

Juneau's prices have remained relatively consistent compared to Washington stations that may change them daily, Ouellette said.

Lundberg said some other cities' prices have also remained relatively constant, including Anchorage, which ranged from \$1.31 in December 1996 to \$1.28 during her company's most recent survey. Prices in Honolulu, which dropped from \$1.66 in December 1996 to \$1.60 last September, have actually risen since to \$1.61.

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Tuesday, December 2, 1997

Gasoline prices drop - elsewhere

Last modified at 3:09 p.m. on Tuesday, December 2, 1997

By **MARK SABBATINI**
THE JUNEAU EMPIRE

Gas prices have declined nationally during the past two months and local wholesalers say they are paying less, but the difference isn't showing up at the pump.

The reason, officials said, is somebody is making more money.

The average price for a gallon of self-serve regular unleaded at Juneau's nine gas stations was \$1.4478 on Monday, with stations' prices largely unchanged in recent months. A national survey of 10,000 stations revealed an average price of \$1.1953 about 10 days ago, down from \$1.2742 on Sept. 5, said Trilby Lundberg, owner of Lundberg Survey in Camarillo, Calif.

"I would not be surprised if prices in most cities and the national average falls again because crude oil has slipped" following an agreement by OPEC to boost production, she said today.

Local officials agree Juneau's prices are based on "what the market will bear," although there is disagreement about who is profiting from the decrease in prices. One official said service station operators may be recovering money lost during an earlier price hike, while another said the money may be going to out-of-state corporate offices that control prices.

Prices at other stations in Alaska are also generally not reflecting the national decrease.

Dick Bevens, marketing manager for Petro Marine Services in Southeast Alaska, said his company's wholesale prices have dropped at least a nickel. He said some service stations may not be lowering their prices now because they remained relatively stable during a summer wholesale price increase.

"You can almost see what service station dealers are feeding their families when," he said. "Sometimes it was steak, sometimes it was hot dogs."

A June survey by the Empire found gas prices between \$1.42 and \$1.46 a gallon. Prices rose a few cents in August - a temporary increase at some stations - with current prices between \$1.42 and \$1.48 a gallon.

Bevens said some Seattle gas stations experienced fluctuations as high as 20 cents a gallon.

Some local service stations may be paying the same amount for their gas despite the price drop, said Jeff Hansen, manager of Taku Oil.

He said his company's buying price has dropped 8 cents a gallon during the past two months. But while the gas goes directly from Taku Oil's tanks to three local Union 76 stations, he said Phoenix-based TOSCO Corp. gets to buy the gas and resell it to the stations at whatever price it sets.

"We've seen over time the large companies like Unocal (whose retail operations were purchased by TOSCO) or Chevron in the past will set prices in a town according to what the market's doing," he said. "That's not unusual anywhere."

TOSCO officials did not return phone calls seeking comment this morning.

Eric Hansen, manager of De Hart's Auke Bay Store, said it actually costs him 6 cents a gallon more to buy gas now from his supplier, Delta Western, than it did two months ago. But he said his price of \$1.43 a gallon hasn't changed because "I pretty much stay competitive with our competitors down the road."

Mapco Express is generally cited by officials as setting the trend for local prices. Juneau prices dropped by up to 25 cents a gallon when they first opened a store in 1994, although prices have crept up since.

There appear to have been few price drops in other Alaska cities in recent months.

Cascade Convenience Center in Sitka is charging \$1.62, below the price in a June survey but 6 cents higher than two months ago, said Paul Kerber, a Petro Marine employee. A Ketchikan's station's price has increased 6 cents a gallon to \$1.62 since June and an Anchorage station remained even at \$1.30.

The exception is Fairbanks where some prices have fallen by 10 cents or more a gallon, to below \$1.30 a gallon, because of a recent Mapco opening.

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Operations

[Mgt Discussion](#)

Tesoro Petroleum Corporation, together with its subsidiaries ("Tesoro" or the "Company"), is a natural resource company engaged primarily in petroleum refining and marketing, natural gas exploration and production, marketing and distributing of petroleum products and providing marine logistics services. The Company was incorporated in Delaware in 1968 (a successor by merger to a California corporation incorporated in 1939). For financial information relating to industry segments, see Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and Note B of Notes to Consolidated Financial Statements in Item 8.

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The Company conducts petroleum refining operations in Alaska and sells refined products to a wide variety of customers in Alaska, along the U.S. West Coast, in the Pacific Northwest and in certain Far Eastern markets, including Russia. During 1996, products from the Company's refinery accounted for approximately 79% of these sale volumes, including products received on exchange in the U.S. West Coast market, with the remaining 21% being purchased from other refiners and suppliers. The Company's purchases from other refiners and suppliers declined in 1996 as the Company withdrew from certain California markets which is further discussed below.

Annual Figures : TESORO PETROLEUM CORP /NEW/

	(Year)	(Year)
Balance Sheet Summary	FY 1996	FY 1995
	US\$1000s	US\$1000s
Cash	22,796	13,941
Securities	0	0
Receivables	129,528	79,376
Allowances	1,515	1,842
Inventory	74,488	80,453
Current Assets	237,343	182,464
Property and Equipment, Net	573,353	478,880
Depreciation	256,842	217,191
Total Assets	582,587	519,153
Current Liabilities	137,868	104,935
Bonds	79,260	155,007
Preferred Mandatory	0	0
Preferred Stock	0	0
Common Stock	4,402	4,130
Other Stockholders' Equity	299,663	212,384
Total Liabilities and Equity	582,587	519,153

Income Statement Summary

Total Revenues	1,039,778	1,002,883
Cost of Sales	854,311	855,187
Other Expenses	41,459	42,620
Loss Provision	0	0
Interest Expense	15,382	20,902
Income Pre Tax	115,147	61,868
Income Tax	38,347	4,379
Income Continuing	76,800	57,489
Discontinued	0	0
Extraordinary	-2,290	-2,857
Changes	0	0
Net Income	74,510	54,632
EPS Primary	2.81\$	2.18\$
EPS Diluted	2.81\$	2.18\$

Quarterly Figures : TESORO PETROLEUM CORP /NEW/

Balance Sheet Summary	9 Mos Ending 9/30/97 US\$1000s	6 Mos Ending 6/30/97 US\$1000s	3 Mos Ending 3/31/97 US\$1000s
Cash	7,379	34,856	31,363
Securities	0	0	0
Receivables	85,319	71,626	85,979
Allowances	1,420	1,466	1,499
Inventory	74,902	73,677	77,577
Current Assets	175,632	188,111	201,749
Property and Equipment, Net	667,918	617,941	589,182
Depreciation	291,113	279,832	268,471
Total Assets	587,814	557,218	551,971
Current Liabilities	99,769	91,540	97,033
Bonds	90,104	77,987	79,063
Preferred Mandatory	0	0	0
Preferred Stock	0	0	0
Common Stock	4,416	4,409	4,406
Other Stockholders' Equity	323,187	315,240	306,008
Total Liabilities and Equity	587,814	557,218	551,971

Income Statement Summary

Total Revenues	699,630	448,158	234,852
Cost of Sales	611,168	390,409	208,215
Other Expenses	34,643	23,140	11,747
Loss Provision	0	0	0
Interest Expense	4,634	3,153	1,570
Income Pre Tax	38,040	24,679	9,575
Income Tax	14,292	8,910	3,444
Income Continuing	23,748	15,769	6,131
Discontinued	0	0	0
Extraordinary	0	0	0
Changes	0	0	0
Net Income	23,748	15,769	6,131
EPS Primary	0.88\$	0.59\$	0.23\$
EPS Diluted	0.88\$	0.59\$	0.23\$

Mgt Discussion : TESORO PETROLEUM CORP /NEW/

Mgt Disc SEP 1997 Mgt Disc JUN 1997 Mgt Disc MAR 1997

[Dated SEP 1997]

Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 herein.

INCENTIVE COMPENSATION STRATEGY

In June 1996, the Company's Board of Directors unanimously approved a special incentive compensation strategy in order to encourage a longer-term focus for all employees to perform at an outstanding level. The strategy provides eligible employees with incentives to achieve a significant increase in the market price of the Company's Common Stock. Under the strategy, awards would be earned only if the market price of the Company's Common

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Stock reaches an average price per share of \$20 or higher over any 20 consecutive trading days after June 30, 1997 and before December 31, 1998 (the "Performance Target"). In connection with this strategy, non-executive employees will be able to earn cash bonuses equal to 25% of their individual payroll amounts for the previous twelve complete months and certain executives have been granted, from the Company's Amended and Restated Executive Long-Term Incentive Plan ("Plan"), a total of 340,000 stock options at an exercise price of \$11.375 per share, the fair market value (as defined in the Plan) of a share of the Company's Common Stock on the date of grant, and 350,000 shares of restricted Common Stock, all of which vest only upon achieving the Performance Target.

NOTE 6 - ACCOUNTING PRONOUNCEMENTS

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 becomes effective for the Company in the fourth quarter of 1997. At that time, the Company will be required to present "basic" and "diluted" earnings per share and to restate earnings per share data presented in prior periods. Early adoption is not permitted. The Company believes that the adoption of SFAS No. 128 will not materially impact its earnings per share disclosures.

In June 1997, the FASB issued SFAS No.130, "Reporting Comprehensive Income," and SFAS No.131, "Disclosures about Segments of an Enterprise and Related Information." Both Statements become effective for periods beginning after December 15, 1997 with early adoption permitted. The Company is evaluating the effects these Statements will have on its financial reporting and disclosures. The Statements will have no effect on the Company's results of operations, financial position, capital resources or liquidity.

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ITEM 2.

TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS - THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1996

SUMMARY

Net earnings of \$8.0 million, or \$.30 per share, for the three months ended September 30, 1997 ("1997 Quarter") compare with net earnings of \$13.9 million, or \$.52 per share, for the three months ended September 30, 1996 ("1996 Quarter"). For the year-to-date period, net earnings of \$23.8 million, or \$.88 per share, for the nine months ended September 30, 1997 ("1997 Period") compare with net earnings of \$31.9 million, or \$1.21 per share, for the nine months ended September 30, 1996 ("1996 Period"). Results for the 1996 Quarter and Period included revenues from sales of natural gas at above-market prices under a contract with Tennessee Gas Pipeline Company ("Tennessee Gas") which was terminated effective October 1, 1996. Results of operations in 1997 and future years will no longer include above-market revenues from this contract. Significant items, including the impact of the Tennessee Gas contract, which affect the comparability between results for 1997 and 1996 are highlighted in the table below (in millions except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Net Earnings As Reported	\$ 8.0	13.9	23.8	31.9
Extraordinary Loss on Debt Extinguishment, Net of Income Tax Benefit	-	2.3	-	2.3
Earnings Before Extraordinary Item	8.0	16.2	23.8	34.2
Significant Items Affecting Comparability, Pretax:				
Operating profit from excess of Tennessee Gas contract prices over spot market prices	-	8.5	-	24.6
Interest and reimbursement of fees and costs from resolution of litigation	-	7.9	-	7.9
Income from collection of Bolivian receivable	-	-	2.2	-
Income from retroactive severance tax refunds	-	-	1.8	5.0
Costs of shareholder consent solicitation resolved in April 1996	-	-	-	(2.3)
Employee terminations, restructuring costs and other	-	(.7)	-	(4.5)
Total Significant Items, Pretax	-	15.7	4.0	30.7
Income Tax Effect	-	4.4	1.2	8.3
Total Significant Items, Aftertax	-	11.3	2.8	22.4
Net Earnings Excluding Significant Items and Extraordinary Loss	\$ 8.0	4.9	21.0	11.8

Earnings Per Share:				
As Reported	\$	.30	.52	.88
Extraordinary Loss		-	(.09)	-
Significant Items:				
Impact of Tennessee Gas contract prices over				
spot market prices		-	.23	-
Other significant items		-	.20	.10
Excluding Significant Items and Extraordinary Loss	\$	.30	.18	.78
		=====	=====	=====

As shown above, net earnings of \$8.0 million (\$.30 per share) in the 1997 Quarter would compare to \$4.9 million (\$.18 per share) when excluding the significant items in the 1996 Quarter. The resulting increase in net earnings in the 1997 Quarter was mainly attributable to improved profitability from each of the Company's business segments together with lower corporate interest expense. For the year-to-date periods, excluding significant items, net earnings would have been \$21.0 million (\$.78 per share) for the 1997 Period compared to \$11.8 million (\$.45 per share) for the 1996 Period. The increase in the 1997 Period was primarily due to higher spot market natural gas prices, better refined product margins and lower corporate interest expense. A discussion and analysis of the factors contributing to the Company's results of operations are presented below. The Company conducts its operations in the following business segments: Refining and Marketing, Exploration and Production, and Marine Services.

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REFINING AND MARKETING	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(Dollars in millions except per unit amounts)	1997	1996	1997	1996
	-----	-----	-----	-----
Gross Operating Revenues:				
Refined products	\$ 177.5	169.9	486.9	465.7
Other, primarily crude oil resales and merchandise	21.3	33.8	48.1	98.1
	-----	-----	-----	-----
Gross Operating Revenues	\$ 198.8	203.7	535.0	563.8
	=====	=====	=====	=====
Total Operating Profit:				
Gross margin	\$ 34.2	31.7	94.8	85.5
Operating expenses	23.3	22.3	68.7	67.1
Depreciation and amortization	3.4	3.0	9.7	9.0
Loss on sale of assets and other	.1	.7	.1	.7
	-----	-----	-----	-----
Operating Profit	\$ 7.4	5.7	16.3	8.7
	=====	=====	=====	=====
Capital Expenditures	\$ 11.8	3.1	30.6	6.9
	=====	=====	=====	=====
Refinery Throughput:				
Barrels per day	43,192	41,165	48,225	45,760
% Alaska North Slope crude oil	68%	69%	77%	71%

Refined Products Manufactured (average daily barrels):				
Gasoline	11,351	10,953	12,499	12,717
Middle distillates	17,999	17,690	20,400	19,143
Heavy oils and residual product	12,587	11,638	14,140	12,829
Other	1,910	2,214	2,500	2,709
Total Refined Products Manufactured	43,847	42,495	49,539	47,398
=====				
Refinery Operations - Product Spread (\$/barrel):				
Average yield value of products manufactured	\$ 23.81	25.07	23.83	23.87
Cost of raw materials	17.92	19.33	18.69	19.03
Refinery Product Spread	\$ 5.89	5.74	5.14	4.84
=====				
Non-Refinery Margin, included in operating profit				
above (\$ millions)	\$ 10.8	10.0	27.1	24.9
=====				
Total Segment Product Sales (average daily barrels):				
Gasoline	18,592	18,073	18,156	18,751
Middle distillates	37,844	32,123	30,138	30,159
Heavy oils and residual product	13,748	16,489	17,700	14,594
Total Product Sales	70,184	66,685	65,994	63,504
=====				
Total Segment Product Sales Prices (\$/barrel):				
Gasoline	\$ 35.23	34.52	33.90	32.35
Middle distillates	\$ 27.00	29.33	28.46	28.08
Heavy oils and residual product	\$ 18.40	17.03	17.53	16.86
Total Segment Gross Margin: on Product				
Sales (\$/barrel):				
Average sales price	\$ 27.49	27.70	27.03	26.76
Average costs of sales	22.80	23.16	22.52	22.43
Gross Margin	\$ 4.69	4.54	4.51	4.33
=====				

Amounts reported in prior periods have been reclassified to conform with current presentation.

Non-refinery margin includes margins on products purchased and resold, margins on products sold in markets outside of Alaska, intrasegment pipeline revenues, retail margins, and adjustments due to selling a volume and mix of products that is different than actual volumes manufactured.

Sources of total products sales include products manufactured at the refinery, products drawn from inventory balances and products purchased from third parties. The Company's purchases of refined products for resale averaged approximately 24,700 and 13,600 barrels per day for the three months ended September 30, 1997 and 1996, respectively, and approximately 15,500 and 12,100 barrels per day for the nine months ended September 30, 1997 and 1996, respectively.

Gross margins on total product sales include margins on sales of purchased products, together with the effect of changes in inventories.

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REFINING AND MARKETING

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.4 million from the Company's Refining and Marketing

segment during the 1997 Quarter represented a 30% improvement from the 1996 Quarter. The continued success of the Company's program to sell a larger portion of its refinery production within the core Alaska market, together with generally favorable industry conditions, contributed to this improvement. The Company's sales of gasoline and asphalt in Alaska increased in the 1997 Quarter as compared to the 1996 Quarter. Jet fuel sales also increased due to growing trans-Pacific air cargo traffic through the international airport in Anchorage.

The Company's refinery product spread averaged \$5.89 per barrel in the 1997 Quarter, a \$.15 per barrel improvement from the 1996 Quarter. The Company's refined product yield values decreased by 5% to \$23.81 per barrel in the 1997 Quarter from \$25.07 per barrel in the 1996 Quarter, while the Company's feedstock costs decreased by 7% to \$17.92 per barrel in the 1997 Quarter from \$19.33 per barrel in the 1996 Quarter. The 1997 Quarter and 1996 Quarter both included scheduled turnarounds, during which the refinery was not fully operational. Margins from non-refinery activities increased to \$10.8 million during the 1997 Quarter from \$10.0 million in the 1996 Quarter due primarily to higher retail sales and improved margins on refined products sold outside Alaska.

The increase of \$7.6 million in revenues from refined products sales during the 1997 Quarter was primarily due to higher sales volumes, which rose 5% to 70,184 barrels per day in the 1997 Quarter from 66,685 barrels per day in the 1996 Quarter. Other revenues declined by \$12.5 million due primarily to lower sales volumes of previously purchased crude oil together with lower prices. During the 1997 Quarter, the Company had less crude oil available for resale as refinery throughput averaged 2,027 barrels per day more than in the 1996 Quarter. Costs of sales decreased in the 1997 Quarter due to lower prices for crude oil and refined products. The \$1.0 million increase in operating expenses included higher employee costs associated in part with expanded marketing efforts and higher professional fees. The 1996 Quarter included a \$.7 million write-down of a West Coast terminal that was subsequently sold.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$16.3 million in the 1997 Period compares to operating profit of \$8.7 million in the 1996 Period. The Company's refinery spread of \$5.14 per barrel in the 1997 Period improved 6% from the prior year period. The Company's production of jet fuel, a product in short supply in Alaska, was higher in the 1997 Period principally due to the use of an improved catalyst in the hydrocracker unit, a change made during the refinery turnaround in the 1996 Period. Margins from non-refinery activities increased to \$27.1 million during the 1997 Period as compared to \$24.9 million in the 1996 Period due primarily to higher retail sales and improved margins on refined products sold outside of Alaska.

Revenues from sales of refined products in the Company's Refining and Marketing segment increased by 5% during the 1997 Period due to higher sales volumes and prices. Other revenues declined by \$50.0 million during the 1997 Period due primarily to lower sales volumes of crude oil together with lower prices. During the 1997 Period, the Company had less crude oil available for

resale as refinery throughput averaged 2,465 barrels per day more than in the 1996 Period and fewer spot purchases of crude oil were made. Costs of sales decreased in the 1997 Period due to lower volumes of crude oil. The \$1.6 million increase in operating expenses included higher employee costs and professional fees.

FUTURE IMPACT. The improvement in Refining and Marketing results have been due in part to the Company's marketing program to sell a larger portion of its refinery production within the core Alaska market. In addition, favorable summer and fall weather conditions in Alaska increased the demand for the Company's in-state sales during the 1997 Period. In early October 1997, the Company completed an expansion of its refinery hydrocracker unit, which increases the unit's capacity by approximately 25% to 12,500 barrels per day and enables the Company to produce more jet fuel. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of \$19 million with a projected payback period of two years and is expected to favorably impact this segment's results beginning in the fourth quarter of 1997. The Company is also expanding its Alaskan retail operations with the construction of new outlets and remodeling of existing outlets. With respect to crude oil supply, beginning in October 1997, a subsidiary of the Company has contracts to purchase all of the approximately 34,000 barrels per day of Cook Inlet production for various periods of more than one year. In the 1997 Period, the Company processed approximately 9,300 barrels per day of Cook Inlet crude, or 19% of the refinery's throughput. The increase in Cook Inlet crude oil as a refinery feedstock will enable the Company to

*Crude to
Subsidiary*

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produce higher-valued products. Although the aforementioned initiatives are expected to improve the fundamental earnings potential of this segment, future profitability of this segment will continue to be influenced by market conditions, particularly as these conditions influence costs of crude oil relative to prices received for sales of refined products, and other additional factors that are beyond the control of the Company.

EXPLORATION AND PRODUCTION	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
(Dollars in millions except per unit amounts)				
U.S.:				
Gross Operating Revenues	\$ 15.9	23.0	53.3	73.4
Other Income (primarily retroactive severance tax refunds)	-	-	1.9	5.0
Production Costs	1.5	1.3	5.0	3.8
Administrative Support and Other Operating Expenses . . .	.6	.2	1.7	2.2
Depreciation, Depletion and Amortization	7.0	6.2	22.2	18.9
Operating Profit - U.S.	6.8	15.3	26.3	53.5
BOLIVIA:				
Gross Operating Revenues	3.8	3.4	8.4	10.5
Other Income (related to collection of a receivable) . .	-	-	2.2	-
Production Costs	.3	.2	.7	.6

Administrative Support and Other Operating Expenses	.5	.6	1.3	2.1
Depreciation, Depletion and Amortization.	.5	.4	1.0	1.0
Operating Profit - Bolivia	2.5	2.2	7.6	6.8
TOTAL OPERATING PROFIT - EXPLORATION AND PRODUCTION	\$ 9.3	17.5	33.9	60.3
U.S.:				
Average Daily Net Production:				
Natural gas (Mcf)	79,683	80,612	86,317	88,723
Oil (barrels)	93	39	119	15
Average Prices:				
Natural gas (\$/Mcf) -				
Spot market	\$ 2.01	1.71	2.08	1.77
Average	\$ 2.01	2.92	2.08	2.85
Oil (\$/barrel)	\$ 18.23	20.93	19.44	20.59
Average Operating Expenses (\$/Mcf) -				
Lease operating expenses	\$.21	.14	.18	.12
Severance taxes	-	.04	.03	.04
Total Production Costs	.21	.18	.21	.16
Administrative support	.09	.01	.07	.08
Total Operating Expenses	\$.30	.19	.28	.24
Depletion (\$/Mcf)	\$.93	.82	.92	.77
Capital Expenditures	\$ 16.3	11.7	32.5	27.1
BOLIVIA:				
Average Daily Net Production:				
Natural gas (Mcf)	26,856	20,945	18,452	21,355
Condensate (barrels)	760	605	529	611
Average Prices:				
Natural gas (\$/Mcf)	\$ 1.13	1.31	1.20	1.33
Condensate (\$/barrel)	\$ 15.00	16.92	16.23	16.50
Average Operating Expenses (\$/Mcf) -				
Production costs	\$.10	.11	.11	.10
Value-added taxes	-	.08	-	.07
Administrative support	.20	.24	.25	.24
Total Operating Expenses	\$.30	.43	.36	.41
Depletion (\$/Mcf)	\$.19	.17	.18	.15
Capital Expenditures	\$ 20.0	.8	26.0	5.7

Represents the Company's U.S. oil and gas operations combined with gas transportation activities. Results for 1996 included revenues from above-market pricing provisions of a contract with Tennessee Gas which was terminated effective October 1, 1996. Operating profit for the three and nine months ended September 30, 1996 included \$8.5 million and \$24.6 million, respectively, for the excess of these contract prices over spot market prices. Net natural

gas production sold under the contract averaged approximately 14 Mmcf per day for both the three months and nine months ended September 30, 1996. Includes effects of the Company's natural gas commodity price agreements which amounted to a loss of \$.19 per Mcf for the three months ended September 30, 1996, and losses of \$.06 per Mcf and \$.15

per Mcf for the nine months ended September 30, 1997 and 1996, respectively. Mcf is defined as one thousand cubic feet; Mcfe is defined as net equivalent one thousand cubic feet.

EXPLORATION AND PRODUCTION - U. S.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$6.8 million from the Company's U.S. operations in the 1997 Quarter compares to operating profit of \$15.3 million in the 1996 Quarter. The 1996 Quarter included revenues from the sale of natural gas at above-market prices under a contract with Tennessee Gas. The excess of these contract prices over spot market prices contributed approximately \$8.5 million to operating profit in the 1996 Quarter. When excluding the incremental value of the Tennessee Gas contract from the 1996 Quarter, operating profit from the Company's U.S. operations for the 1997 Quarter would be relatively unchanged as total production volumes remained flat during both quarters and increases in spot market natural gas prices were offset by increased depreciation and depletion and operating expenses.

Prices realized by the Company on spot market natural gas production increased to \$2.01 per Mcf in the 1997 Quarter from \$1.71 per Mcf in the 1996 Quarter. On a weighted-average basis, the Company's natural gas sales price was \$2.92 per Mcf in the 1996 Quarter due to sales under the Tennessee Gas contract. The Company's production averaged 80.2 million cubic feet equivalents ("Mmcfe") per day in the 1997 Quarter compared to 80.8 Mmcfe per day in the 1996 Quarter. This decrease in the Company's production consisted of a 14.0 million cubic feet ("Mmcf") per day decline from the Bob West Field partially offset by a 13.4 Mmcfe per day production increase from other U.S. fields. The Company's production outside of the Bob West Field rose to 23% of total production during the 1997 Quarter, as compared to 6% in the 1996 Quarter. In September 1997, production began from the Company's interest in the Vinegarone East Field in Val Verde Basin of Southwest Texas at an initial flow rate of approximately 12 Mmcf per day gross (8.6 Mmcf per day net). Drilling is underway on two development wells in this field. In addition, the Cuellar 1 well, which was discovered during the 1997 Quarter in the Wilcox Trend of South Texas, began production in October 1997 at 8.0 Mmcf per day gross (6.0 Mmcf per day net). The Company's net U.S. production reached 90 Mmcf per day in late October 1997.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$.2 million in the 1997 Quarter due primarily to higher per-unit lease operating expenses from the Company's newer fields. Depreciation and depletion increased by \$.8 million, or 13%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuation in the prices of natural gas in the spot market. During the 1996 Quarter, the Company used such agreements to set the price of 38% of the natural gas production that it sold in the spot market and recognized a loss of \$1.2 million (\$.19 per Mcf) related to these price agreements. The Company did not have any such transactions during the 1997 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$26.3 million from the Company's U.S. operations in the 1997 Period compares to \$53.5 million in the 1996 Period. Comparability between these periods was impacted by certain significant items. The 1996 Period included operating profit of \$24.6 million from the excess of Tennessee Gas contract prices over spot market prices. Results of operations in 1997 and future years will no longer include above-market revenues from this contract which was terminated effective October 1, 1996. Operating profit also included retroactive severance tax refunds of \$1.8 million and \$5.0 million in the 1997 and 1996 Periods, respectively. Excluding the incremental value of the Tennessee Gas contract and retroactive severance tax refunds, operating profit from the Company's U.S. operations would have been \$24.5 million in the 1997 Period compared to \$23.9 million in the 1996 Period. The resulting increase of \$.6 million was primarily attributable to higher spot market prices for sales of natural gas partially offset by higher depreciation and depletion.

Prices realized by the Company on its spot natural gas production increased 18% to \$2.08 per Mcf in the 1997 Period from \$1.77 per Mcf in the 1996 Period. The increase in average spot market prices was attributable in part to unusually high prices received during January and February when there was unusually cold weather combined with below-normal natural gas storage levels. On a weighted-average basis, the Company's natural

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gas sales price was \$2.85 per Mcf in the 1996 Period due to sales under the Tennessee Gas contract. The Company's production averaged 87.0 Mmcfe per day in the 1997 Period, a decrease of 1.8 Mmcfe per day from the 1996 Period. This decrease in the Company's production consisted of a 13.9 Mmcfe per day decline from the Bob West Field partially offset by a 12.1 Mmcfe per day increase from other U.S. fields. Production from the Bob West Field, which accounted for 95% of the Company's total U.S. production in the 1996 Period, was reduced to 81% in the 1997 Period.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$1.2 million during the 1997 Period due to higher per-unit lease operating expenses from the Company's newer fields. Administrative support and other operating expenses decreased by \$.5 million. Depreciation and depletion increased by \$3.3 million, or 17%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuations in the prices of natural gas in the spot market. In addition, from time to time the Company has entered into price agreements with collars, under which no payments will be made by either party unless the price falls below a designated floor price or above a designated ceiling price, at which time the Company receives or pays the difference, respectively. During the 1997 and 1996 Periods, the Company used such agreements to set the price of 11% and 37%, respectively, of the natural gas production that it sold in the spot market. During the 1997 and 1996 Periods, the

Company realized losses of \$1.6 million (\$.06 per Mcf) and \$2.9 million (\$.15 per Mcf), respectively, from these price agreements. At September 30, 1997, the Company has no remaining price agreements outstanding for the year.

EXPLORATION AND PRODUCTION - BOLIVIA

HYDROCARBONS LAW. In 1996, a new Hydrocarbons Law was passed by the Bolivian government that significantly impacts the Company's operations in Bolivia. The new law, among other matters, granted the Company the option to convert its Contracts of Operation to new Shared Risk Contracts. On November 6, 1997, the Company completed the conversion of its Contracts of Operation for Block 18 and Block 20 into four Shared Risk Contracts. The new contracts have an effective date of July 29, 1996 and extend the Company's term of operation, provide more favorable acreage relinquishment terms and provide for a more favorable fiscal regime of royalties and taxes. The new contract for Block 18 is extended to the year 2017. The new contracts for Block 20 are extended to the year 2029 for Block 20-West and Block 20-East, which are in the exploration phase, and to the year 2018 for Block 20-Los Suris that is in the development phase.

FARMOUT. A farmout agreement executed June 19, 1997, between the Company and Total Exploration Production Bolivia, S.A. ("Total"), an affiliate of Total S.A., became effective on a portion of Block 20-West on November 6, 1997. Pursuant to the farmout agreement, Total established a financial guarantee to the Bolivian government to guarantee the performance of exploration work on Block 20-West. Under the farmout agreement, Total has the right to drill, at its sole cost, two exploratory wells to earn a 75 percent interest in the farmout area which consists of 315,000 acres of Block 20-West. The assignment of interest by the Company to Total, which is subject to reversion if Total does not earn the interest, has been approved by the Bolivian government and is expected to become effective in the fourth quarter of 1997. It is anticipated that Total will spud the first well by mid-1998.

YPFB AND YPF CONTRACT. The Company's Bolivian natural gas production has been sold to Yacimientos Petroliferos Fiscales Bolivianos ("YPFB"), which in turn sells the natural gas to Yacimientos Petroliferos Fiscales, SA ("YPF"), a publicly-held company based in Argentina. Currently, the Company's sales of natural gas production is based on the volume and pricing terms in the contract between YPFB and YPF. The contract to sell gas to YPF expired March 31, 1997 and a contract extension was signed effective April 1, 1997 extending the contract term two years to March 31, 1999 with an option to extend the contract a maximum of one additional year if the pipeline being constructed from Bolivia to Brazil is not complete. In the contract extension, YPF negotiated an 11% reduction in the minimum contract volume it is required to import from Bolivia, which in turn resulted in a corresponding 11% reduction of Tesoro's minimum contract volume.

ACCESS TO NEW MARKETS. A lack of market access has constrained natural gas production in Bolivia. Preliminary work on a new 1,900-mile pipeline that will link Bolivia's gas reserves with markets in Brazil has begun and the pipeline is expected to be operational in early 1999.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$2.5 million from the Company's Bolivian operations in the 1997 Quarter compares to

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operating profit of \$2.2 million in the 1996 Quarter. With the Company's purchase of Zapata's Interests in Block 18 and Block 20 in July 1997, the Company now holds a 100% interest in both blocks, subject to the farmout agreement with Total (see Note 2 of Notes to Condensed Consolidated Financial Statements). Beginning in the 1997 Quarter, the Company's net share of production from Block 18 increased by approximately 33% as a result of this purchase. Block 20 is currently shut-in waiting on the construction of the pipeline to Brazil, which is expected to be operational in early 1999. Natural gas prices for Bolivian production fell to \$1.13 per Mcf in the 1997 Quarter, a 14% drop from the 1996 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.6 million from the Company's Bolivian operations in the 1997 Period compares to operating profit of \$6.8 million in the 1996 Period. The 1997 Period included income of \$2.2 million related to the collection of a receivable for prior years production. Excluding this income, operating profit would have decreased by \$1.4 million as production of natural gas and condensate fell by 14%. As discussed above, the Company's production rose during the 1997 Quarter due to the purchase of the Zapata interests in July 1997 which will also benefit future periods. However, earlier in the year, the Company's Bolivian natural gas production was lower due to a reduction in minimum takes under the new contract between YPFB and YPF and also due to constraints arising from repairs to a non-Company-owned pipeline that transports gas from Bolivia to Argentina. A replacement pipeline is now operational, which has restored full capacity. During the 1996 Period, production was higher due to requests from YPFB for additional production from the Company to meet export specifications. Natural gas prices declined to \$1.20 per Mcf in the 1997 Period compared to \$1.33 per Mcf in the 1996 Period. Administrative support and other operating expenses decreased by \$.8 million in the 1997 Period due primarily to the reduced production levels.

MARINE SERVICES

(Dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Gross Operating Revenues:				
Fuels	\$ 25.2	26.0	77.6	70.4
Lubricants and other	4.2	4.1	12.3	10.9
Services	3.1	2.6	8.4	6.2
Gross Operating Revenues	32.5	32.7	98.3	87.5
Costs of Sales	22.9	24.5	72.6	66.7

Gross Profit	9.6	8.2	25.7	20.8
Operating Expenses and Other	6.5	5.8	20.4	15.4
Depreciation and Amortization	.4	.4	1.2	.9
Operating Profit	\$ 2.7	2.0	4.1	4.5
Sales Volumes (millions of gallons):				
Fuels, primarily diesel	39.1	37.8	116.2	107.4
Lubricants	.7	.7	2.0	1.9
Capital Expenditures	\$ 2.0	1.2	5.3	6.2

For the 1997 Quarter, gross operating revenues declined by \$.2 million due primarily to lower fuel sales prices partly offset by increased fuel volumes. The \$1.6 million decrease in cost of sales correlates to these lower fuel market prices. The 19% increase in service revenues was associated with the increased rig activity in the Gulf of Mexico and the Company's focus to serve these customers. The improvement of \$1.4 million in gross profit was partly offset by higher operating expenses associated with the increased sales volumes and service revenues.

For the 1997 Period, gross operating revenues increased by \$10.8 million, with an 11% increase in fuels and lubricants revenues and a 35% increase in service revenues. These increases were mainly due to added locations and associated volumes stemming from an acquisition consummated in February 1996 together with internal growth initiatives. Costs of sales during the 1997 Period increased due to the higher volumes and also included a \$.7 million charge associated with inventory valuations as market prices declined from year-end levels. The improvement of \$4.9 million in gross profit during the 1997 Period was offset by higher operating and other expenses associated with the increased activity and upgrades to facilities and services.

The Marine Services segment's business is largely dependent upon the volume of oil and gas drilling, workover, construction and seismic activity in the Gulf of Mexico.

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GENERAL AND ADMINISTRATIVE

General and administrative expense increased by \$.3 million and \$.6 million during the 1997 Quarter and Period, respectively. These increases were primarily due to higher employee costs partially offset by reduced professional fees and insurance costs.

INTEREST EXPENSE AND INTEREST INCOME

Interest expense decreased by \$2.6 million and \$7.5 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to the Company's redemption of \$74.1 million of public debt in November 1996 which has resulted in interest expense savings of approximately 60% in the 1997 Quarter and Period.

Interest income decreased by \$6.9 million and \$6.2 million during the 1997 Quarter and Period, respectively. The 1996 Quarter and Period included interest of approximately \$7 million received from Tennessee Gas in conjunction with the collection of a receivable which resulted from underpayment for natural gas sold in prior periods. The 1997 Period included interest income of approximately \$.4 million related to the collection of a Bolivia receivable.

OTHER EXPENSE, NET

For the 1997 Period, other expense decreased by \$5.3 million primarily due to charges incurred in the prior year period for shareholder consent solicitation costs of \$2.3 million, which was resolved in April 1996, together with a write-off of deferred financing costs and employee termination costs with no material comparable costs recorded in the current period.

INCOME TAX PROVISION

Income taxes decreased by \$2.2 million and \$2.8 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to lower earnings.

IMPACT OF CHANGING PRICES

The Company's operating results and cash flows are sensitive to the volatile changes in energy prices. Major shifts in the cost of crude oil used for refinery feedstocks and the price of refined products can result in a change in margin from the Refining and Marketing operations, as prices received for refined products may or may not keep pace with changes in crude oil costs. These energy prices, together with volume levels, also determine the carrying value of crude oil and refined product inventory. The Company uses the last-in, first-out ("LIFO") method of accounting for inventories of crude oil and U.S. wholesale refined products. This method results in inventory carrying amounts that are less likely to represent current values and in costs of sales which more closely represent current costs.

Likewise, changes in natural gas, condensate and oil prices impact revenues and the present value of estimated future net revenues and cash flows from the Company's Exploration and Production operations. The Company may increase or decrease its production in response to market conditions. The carrying value of oil and natural gas assets may be subject to noncash writedowns based on changes in natural gas prices and other determining factors.

Changes in natural gas prices also influence the level of drilling activity in the Gulf of Mexico. The Company's Marine Services operation, whose customers include offshore drilling contractors and related industries, could be impacted by significant fluctuations in natural gas prices. The Company's Marine Services segment uses the first-in, first-out ("FIFO") method of accounting for its inventories of fuel. Changes in fuel prices can significantly impact inventory valuations and costs

of sales in this segment.

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CAPITAL RESOURCES AND LIQUIDITY

OVERVIEW

The Company's primary sources of liquidity are its cash and cash equivalents, internal cash generation and external financing. During the first nine months of 1997, the Company made capital expenditures exceeding \$95 million, which were funded through a combination of cash flows from operations of \$71 million, external financing of \$16 million and available cash balances. Subsequently, in October 1997, the Company obtained a \$16.2 million term loan to finance the expansion of the refinery hydrocracker unit (see Note 3 of Notes to Condensed Consolidated Financial Statements). At September 30, 1997, the Company's debt-to-capitalization ratio was 22% which enhances the Company's ability to access capital markets.

The Company is focused on its strategic plans to make operational improvements and continues to assess its asset base in order to maximize returns and develop full value through strategic diversification and acquisitions in all of its operating segments. This ongoing assessment includes, in the Exploration and Production segment, evaluating ways in which the Company could diversify its oil and gas reserve base and offset the impact of declining production through domestic development, exploration and acquisition outside of the Bob West Field. In the Refining and Marketing segment, the Company has been engaged in studies to improve profitability and has also

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TESORO PETROLEUM CORP /NEW/

CENTRAL INDEX KEY:

0000050104

STANDARD INDUSTRIAL CLASSIFICATION:

PETROLEUM REFINING [2911]

IRS NUMBER:

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STATE OF INCORPORATION:

DE

FISCAL YEAR END:

1231

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BUSINESS ADDRESS:

STREET 1: 8700 TESORO DR

CITY: SAN ANTONIO

STATE: TX

ZIP: 78217

BUSINESS PHONE: 2108288484

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-3473

TESORO PETROLEUM CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	95-0862768
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

8700 TESORO DRIVE, SAN ANTONIO, TEXAS 78217-6218
(Address of Principal Executive Offices) (Zip Code)

210-828-8484
(Registrant's Telephone Number, Including Area Code)

=====

Indicate by check mark whether the Registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the

Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No
----- -----

=====

There were 26,750,314 shares of the Registrant's Common Stock outstanding at October 31, 1997.

<PAGE>

TESORO PETROLEUM CORPORATION AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997

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PART I - FINANCIAL INFORMATION

ITEM 1.

FINANCIAL STATEMENTS

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<CAPTION>

TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands except per share amounts)

	September 30, 1997 ----	December 31, 1996<FN1> ----
ASSETS		
<S>	<C>	<C>
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,379	22,796
Receivables, less allowance for doubtful accounts of \$1,420 (\$1,515 at December 31, 1996).	83,899	128,013
Inventories:		
Crude oil and wholesale refined products, at LIFO.	55,431	55,858
Merchandise and other refined products	14,333	13,539
Materials and supplies	5,138	5,091
Prepayments and other	9,452	12,046
	-----	-----
Total Current Assets.	175,632	237,343
	-----	-----
PROPERTY, PLANT AND EQUIPMENT		
Refining and marketing.	358,792	328,522
Exploration and production (full-cost method of accounting) . .	257,003	198,480
Marine services	38,953	33,820
Corporate	13,170	12,531
	-----	-----
	667,918	573,353

Less accumulated depreciation, depletion and amortization. . .	291,113	256,842
Net Property, Plant and Equipment	376,805	316,511
OTHER ASSETS	35,377	28,733
TOTAL ASSETS	\$ 587,814	582,587
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Accounts payable.	\$ 57,473	80,747
Accrued liabilities	30,567	33,256
Current income taxes payable.	1,951	13,822
Current maturities of long-term debt and other obligations. . .	9,778	10,043
Total Current Liabilities.	99,769	137,868
	-----	-----

DEFERRED INCOME TAXES.	24,552	19,151
	-----	-----

OTHER LIABILITIES.	45,786	42,243
	-----	-----

LONG-TERM DEBT AND OTHER OBLIGATIONS, LESS CURRENT MATURITIES.	90,104	79,260
	-----	-----

COMMITMENTS AND CONTINGENCIES (Note 4)

STOCKHOLDERS' EQUITY

Common Stock, par value \$.16-2/3; authorized 50,000,000 shares; 26,498,745 shares issued (26,414,134 in 1996).	4,416	4,402
Additional paid-in capital.	190,093	189,368
Retained earnings	134,043	110,295
Treasury stock, 66,998 shares at cost	(949)	-
Total Stockholders' Equity	327,603	304,065
	-----	-----

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.	\$ 587,814	582,587
	=====	=====

<FN>

The accompanying notes are an integral part of these condensed consolidated financial statements.
 <FN1> The balance sheet at December 31, 1996 has been taken from the audited consolidated financial statements at the condensed.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
 CONDENSED STATEMENTS OF CONSOLIDATED OPERATIONS
 (Unaudited)
 (In thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
REVENUES				
Refining and marketing.	\$ 198,815	203,661	534,986	563,767
Exploration and production.	19,821	26,476	61,769	83,933
Marine services	32,433	32,660	98,266	87,467
Other income.	403	(725)	4,609	4,378
	-----	-----	-----	-----
Total Revenues	251,472	262,072	699,630	739,545
	-----	-----	-----	-----
OPERATING COSTS AND EXPENSES				
Refining and marketing.	188,014	194,156	508,926	545,303
Exploration and production.	3,054	2,416	8,836	8,767
Marine services	29,691	30,273	93,406	82,153
Depreciation, depletion and amortization.	11,357	10,026	34,183	29,797
	-----	-----	-----	-----
Total Operating Costs and Expenses	232,116	236,871	645,351	666,020
	-----	-----	-----	-----
OPERATING PROFIT	19,356	25,201	54,279	73,525
General and Administrative	(3,416)	(3,056)	(9,599)	(8,960)
Interest Expense, Net of Capitalized Interest in 1997	(1,481)	(4,142)	(4,634)	(12,142)
Interest Income.	135	7,100	1,459	7,681
Other Expense, Net	(1,233)	(1,254)	(3,465)	(8,802)
	-----	-----	-----	-----
EARNINGS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM.	13,361	23,849	38,040	51,302

Income Tax Provision	5,382	7,686	14,292	17,159
	-----	-----	-----	-----
EARNINGS BEFORE EXTRAORDINARY ITEM	7,979	16,163	23,748	34,143
Extraordinary Loss on Extinguishment of Debt, Net of Income Tax Benefit of \$886 in 1996.	-	(2,290)	-	(2,290)
	-----	-----	-----	-----
NET EARNINGS	\$ 7,979	13,873	23,748	31,853
	=====	=====	=====	=====
 EARNINGS PER SHARE				
Earnings Before Extraordinary Item.	\$.30	.61	.88	1.30
Extraordinary Loss, Net of Income Tax Benefit . . .	-	(.09)	-	(.09)
	-----	-----	-----	-----
Net Earnings.	\$.30	.52	.88	1.21
	=====	=====	=====	=====
 WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES	26,938	26,816	26,857	26,370
	=====	=====	=====	=====

<FN>

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)
(In thousands)

Nine Months Ended
September 30

1997 1996

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CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES

Net earnings	\$ 23,748	31,853
Adjustments to reconcile net earnings to net cash from operating activities:		
Extraordinary loss on extinguishment of debt, net of income tax benefit . .	-	2,290
Depreciation, depletion and amortization.	34,643	30,386
Loss on sale of assets.	30	678
Amortization of deferred charges and other.	622	1,316
Changes in operating assets and liabilities:		
Receivable from Tennessee Gas Pipeline Company.	-	50,680

Receivables, other trade.	45,882	(6,228)
Inventories	358	16,901
Other assets.	(3,219)	793
Accounts payable and other current liabilities.	(38,557)	8,066
Obligation payments to State of Alaska.	(3,406)	(3,145)
Deferred income taxes	5,401	12,051
Other liabilities and obligations	5,569	2,760
	-----	-----
Net cash from operating activities	71,071	148,401
	-----	-----
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(95,082)	(46,050)
Acquisition of Coastwide Energy Services, Inc.	-	(7,720)
Other.	(3,155)	(3,259)
	-----	-----
Net cash used in investing activities.	(98,237)	(57,029)
	-----	-----
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Borrowings, net of repayments of \$28,500 in 1997 and \$112,000 in 1996, under revolving credit facilities.	15,828	-
Payments of long-term debt	(3,287)	(2,885)
Purchase of treasury stock	(1,098)	-
Other.	306	1,144
	-----	-----
Net cash from (used in) financing activities	11,749	(1,741)
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(15,417)	89,631
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	22,796	13,941
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD \$	7,379	103,572
	=====	=====
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Interest paid, net of \$313 capitalized in 1997 \$	1,654	8,879
	=====	=====
Income taxes paid. \$	20,764	3,925
	=====	=====

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The accompanying notes are an integral part of these condensed consolidated financial statements.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

The interim condensed consolidated financial statements and notes thereto of Tesoro Petroleum Corporation and its subsidiaries (collectively, the "Company" or "Tesoro") have been prepared by management without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, the accompanying financial statements reflect all adjustments that, in the opinion of management, are necessary for a fair presentation of results for the periods presented. Such adjustments are of a normal recurring nature. Certain information and notes normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC's rules and regulations. However, management believes that the disclosures presented herein are adequate to make the information not misleading. The accompanying condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 1996.

The preparation of these condensed consolidated financial statements required the use of management's best estimates and judgment that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of results for the full year.

Certain reclassifications have been made to amounts previously reported to conform to the current presentation of financial information.

NOTE 2 - ACQUISITION

In July 1997, the Company purchased the interests held by Zapata Exploration Company ("Zapata"), a wholly-owned subsidiary of Zapata Corporation, in two jointly held contract blocks (Block 18 and Block 20) in southern Bolivia. Zapata held a 25% interest in Block 18 and a 27.4% interest in Block 20. The purchase price was approximately \$20 million, which included working capital and assumption of certain liabilities. The assignment of interests has been approved by the Bolivian government. The Company's net proved Bolivian reserves, which were estimated to be 253 billion cubic feet equivalent at 1996 year-end, increased more than 30% as a result of the acquisition.

NOTE 3 - LONG-TERM DEBT

In September 1997, the Company negotiated an amendment to its \$150 million corporate revolving credit facility ("Credit Facility"). The amendment reduces the rate on cash borrowings under the Credit Facility to (i) the London Interbank Offered Rate ("LIBOR") plus 1.0% or (ii) the prime rate. Fees on outstanding letters of credit are reduced to 1.0%. The amendment also increases the Company's borrowing base and makes certain covenants in the Credit Facility less restrictive. Additionally, the Company is now permitted to utilize unsecured letters of credit outside of the Credit Facility up to \$40 million (none outstanding at September 30, 1997). Under the Credit Facility, the Company had letters of credit of \$33.9 million, primarily for royalty crude oil purchases from the State of Alaska, and cash borrowings of \$11.9 million outstanding at September 30, 1997.

In early October 1997, the Company completed an expansion of the hydrocracker unit at its Alaska refinery. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of approximately \$19 million and is expected to improve the Company's refinery feedstock and product slate beginning in the fourth quarter of 1997. In October 1997, the National Bank of Alaska ("NBA") and the Alaska Industrial Development and Export Authority ("AIDEA"), under a loan agreement ("Hydrocracker Loan") entered into between the Company and NBA, provided a \$16.2 million loan to the Company towards the cost of the hydrocracker expansion. One-half of the loan was funded by NBA and the other half was funded by AIDEA. The Hydrocracker Loan matures on or before April 1, 2005 and requires 28 equal quarterly principal payments beginning April 1998 together with interest at the unsecured 90-day commercial paper rate (5.55% at October 30, 1997) plus (i) 2.6% per annum on 50% of the amount borrowed and (ii) 2.35% per annum on the other 50% borrowed, each to be

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adjusted quarterly. The Hydrocracker Loan is secured by a second lien on the refinery. Under the terms of the Hydrocracker Loan, the Company is required to maintain specified levels of working capital and tangible net worth.

NOTE 4 - COMMITMENTS AND CONTINGENCIES

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, which change frequently, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites or install additional controls or other modifications or changes in use for certain emission sources. The Company is currently involved with a waste disposal site near Abbeville, Louisiana, at which it has been named a potentially responsible party under the Federal Superfund law. Although this law might impose joint and several liability upon each party at the site, the extent of the Company's allocated financial contributions to the cleanup of the site is expected to be limited based upon

the number of companies, volumes of waste involved and an estimated total cost of approximately \$500,000 among all of the parties to close the site. The Company is currently involved in settlement discussions with the Environmental Protection Agency and other potentially responsible parties at the Abbeville, Louisiana site. The Company expects, based on these discussions, that its liability will not exceed \$25,000. The Company is also involved in remedial responses and has incurred cleanup expenditures associated with environmental matters at a number of sites, including certain of its own properties.

At September 30, 1997, the Company's accruals for environmental expenses amounted to \$8.7 million, which included a noncurrent liability of approximately \$3.1 million for remediation of Kenai Pipe Line Company's ("KPL") properties that has been funded by the former owners of KPL through a restricted escrow deposit. Based on currently available information, including the participation of other parties or former owners in remediation actions, the Company believes these accruals are adequate. In addition, to comply with environmental laws and regulations, the Company currently anticipates that it will make capital improvements of approximately \$3 million in 1997 and \$8 million in 1998. The Company also expects to spend approximately \$6 million by the year 2002 for secondary containment systems for existing storage tanks in Alaska.

Conditions that require additional expenditures may exist for various Company sites, including, but not limited to, the Company's refinery, retail gasoline outlets (current and closed locations) and petroleum product terminals, and for compliance with the Clean Air Act. The amount of such future expenditures cannot currently be determined by the Company.

NOTE 5 - STOCKHOLDERS' EQUITY

STOCK REPURCHASE PROGRAM

On May 7, 1997, the Company's Board of Directors authorized the repurchase of up to 3 million shares (approximately 11% of the current outstanding shares) of Tesoro Common Stock in a buyback program that will extend through the end of 1998. Under the program, subject to certain conditions, the Company may repurchase from time to time Tesoro Common Stock in the open market and through privately negotiated transactions. Purchases will depend on price, market conditions and other factors and will be made primarily from cash flows. The repurchased Common Stock is accounted for as treasury stock and may be used for employee benefit plan requirements and other corporate purposes. For further information on the repurchase program and related restrictions, see "Capital Resources and Liquidity" in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 herein.

INCENTIVE COMPENSATION STRATEGY

In June 1996, the Company's Board of Directors unanimously approved a special incentive compensation strategy in order to encourage a longer-term focus for

all employees to perform at an outstanding level. The strategy provides eligible employees with incentives to achieve a significant increase in the market price of the Company's Common Stock. Under the strategy, awards would be earned only if the market price of the Company's Common

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Stock reaches an average price per share of \$20 or higher over any 20 consecutive trading days after June 30, 1997 and before December 31, 1998 (the "Performance Target"). In connection with this strategy, non-executive employees will be able to earn cash bonuses equal to 25% of their individual payroll amounts for the previous twelve complete months and certain executives have been granted, from the Company's Amended and Restated Executive Long-Term Incentive Plan ("Plan"), a total of 340,000 stock options at an exercise price of \$11.375 per share, the fair market value (as defined in the Plan) of a share of the Company's Common Stock on the date of grant, and 350,000 shares of restricted Common Stock, all of which vest only upon achieving the Performance Target.

NOTE 6 - ACCOUNTING PRONOUNCEMENTS

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 becomes effective for the Company in the fourth quarter of 1997. At that time, the Company will be required to present "basic" and "diluted" earnings per share and to restate earnings per share data presented in prior periods. Early adoption is not permitted. The Company believes that the adoption of SFAS No. 128 will not materially impact its earnings per share disclosures.

In June 1997, the FASB issued SFAS No.130, "Reporting Comprehensive Income," and SFAS No.131, "Disclosures about Segments of an Enterprise and Related Information." Both Statements become effective for periods beginning after December 15, 1997 with early adoption permitted. The Company is evaluating the effects these Statements will have on its financial reporting and disclosures. The Statements will have no effect on the Company's results of operations, financial position, capital resources or liquidity.

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ITEM 2. TESORO PETROLEUM CORPORATION AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS - THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1997
COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1996

SUMMARY

Net earnings of \$8.0 million, or \$.30 per share, for the three months ended September 30, 1997 ("1997 Quarter") compare with net earnings of \$13.9 million, or \$.52 per share, for the three months ended September 30, 1996 ("1996 Quarter"). For the year-to-date period, net earnings of \$23.8 million, or \$.88 per share, for the nine months ended September 30, 1997 ("1997 Period") compare with net earnings of \$31.9 million, or \$1.21 per share, for the nine months ended September 30, 1996 ("1996 Period"). Results for the 1996 Quarter and Period included revenues from sales of natural gas at above-market prices under a contract with Tennessee Gas Pipeline Company ("Tennessee Gas") which was terminated effective October 1, 1996. Results of operations in 1997 and future years will no longer include above-market revenues from this contract. Significant items, including the impact of the Tennessee Gas contract, which affect the comparability between results for 1997 and 1996 are highlighted in the table below (in millions except per share amounts):

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Net Earnings As Reported	\$ 8.0	13.9	23.8	31.9
Extraordinary Loss on Debt Extinguishment, Net of Income Tax Benefit.	-	2.3	-	2.3
	-----	-----	-----	-----
Earnings Before Extraordinary Item	8.0	16.2	23.8	34.2
	-----	-----	-----	-----
Significant Items Affecting Comparability, Pretax:				
Operating profit from excess of Tennessee Gas contract prices over spot market prices	-	8.5	-	24.6
Interest and reimbursement of fees and costs from resolution of litigation.	-	7.9	-	7.9
Income from collection of Bolivian receivable.	-	-	2.2	-
Income from retroactive severance tax refunds.	-	-	1.8	5.0
Costs of shareholder consent solicitation resolved in April 1996	-	-	-	(2.3)
Employee terminations, restructuring costs and other	-	(.7)	-	(4.5)
	-----	-----	-----	-----
Total Significant Items, Pretax	-	15.7	4.0	30.7
Income Tax Effect	-	4.4	1.2	8.3
	-----	-----	-----	-----

Total Significant Items, Aftertax	-	11.3	2.8	22.4
	-----	-----	-----	-----
Net Earnings Excluding Significant Items and Extraordinary Loss.	\$ 8.0	4.9	21.0	11.8
	=====	=====	=====	=====
Earnings Per Share:				
As Reported.	\$.30	.52	.88	1.21
Extraordinary Loss	-	(.09)	-	(.09)
Significant Items:				
Impact of Tennessee Gas contract prices over spot market prices	-	.23	-	.68
Other significant items.	-	.20	.10	.17
	-----	-----	-----	-----
Excluding Significant Items and Extraordinary Loss	\$.30	.18	.78	.45
	=====	=====	=====	=====

</TABLE>

As shown above, net earnings of \$8.0 million (\$.30 per share) in the 1997 Quarter would compare to \$4.9 million (\$.18 per share) when excluding the significant items in the 1996 Quarter. The resulting increase in net earnings in the 1997 Quarter was mainly attributable to improved profitability from each of the Company's business segments together with lower corporate interest expense. For the year-to-date periods, excluding significant items, net earnings would have been \$21.0 million (\$.78 per share) for the 1997 Period compared to \$11.8 million (\$.45 per share) for the 1996 Period. The increase in the 1997 Period was primarily due to higher spot market natural gas prices, better refined product margins and lower corporate interest expense. A discussion and analysis of the factors contributing to the Company's results of operations are presented below. The Company conducts its operations in the following business segments: Refining and Marketing, Exploration and Production, and Marine Services.

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REFINING AND MARKETING

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
	----	----	----	----

(Dollars in millions except per unit amounts)

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Gross Operating Revenues:

Refined products.	\$ 177.5	169.9	486.9	465.7
Other, primarily crude oil resales and merchandise.	21.3	33.8	48.1	98.1

	-----	-----	-----	-----
Gross Operating Revenues	\$ 198.8	203.7	535.0	563.8
	=====	=====	=====	=====
Total Operating Profit:				
Gross margin.	\$ 34.2	31.7	94.8 ^{18%}	85.5 ^{15%}
Operating expenses.	23.3	22.3	68.7	67.1
Depreciation and amortization	3.4	3.0	9.7	9.0
Loss on sale of assets and other.	.1	.7	.1	.7
	-----	-----	-----	-----
Operating Profit	\$ 7.4	5.7	16.3	8.7
	=====	=====	=====	=====
Capital Expenditures	\$ 11.8	3.1	30.6	6.9
	=====	=====	=====	=====
Refinery Throughput:				
Barrels per day	43,192	41,165	48,225	45,760
% Alaska North Slope crude oil.	68%	69%	77%	71%
Refined Products Manufactured (average daily barrels)<FN1>:				
Gasoline	11,351	7,953	12,499	12,717
Middle distillates.	17,999	7,690	20,400	19,143
Heavy oils and residual product	12,587	11,638	14,140	12,829
Other	1,910	2,214	2,500	2,709
	-----	-----	-----	-----
Total Refined Products Manufactured.	43,847	42,495	49,539	47,398
	=====	=====	=====	=====
Refinery Operations - Product Spread (\$/barrel)<FN1>:				
Average yield value of products manufactured.	\$ 23.81	25.07	23.83	23.87
Cost of raw materials	17.92	19.33	18.69	19.03
	-----	-----	-----	-----
Refinery Product Spread.	\$ 5.89	5.74	5.14	4.84
	=====	=====	=====	=====
Non-Refinery Margin, included in operating profit above (\$ millions)<FN1><FN2>	\$ 10.8	10.0	27.1	24.9
	=====	=====	=====	=====
Total Segment Product Sales (average daily barrels)<FN3>:				
Gasoline.	18,592	18,073	18,156	18,751
Middle distillates.	37,844	32,123	30,138	30,159
Heavy oils and residual product	13,748	16,489	17,700	14,594
	-----	-----	-----	-----
Total Product Sales.	70,184	66,685	65,994	63,504

	=====	=====	=====	=====
Total Segment Product Sales Prices (\$/barrel):				
Gasoline.	\$ 35.23	34.52	33.90	32.35
Middle distillates.	\$ 27.00	29.33	28.46	28.08
Heavy oils and residual product	\$ 18.40	17.03	17.53	16.86
Total Segment Gross Margins on Product				
Sales (\$/barrel)<FN4>:				
Average sales price	\$ 27.49	27.70	27.03	26.76
Average costs of sales.	22.80	23.16	22.52	22.43
	-----	-----	-----	-----
Gross Margin	\$ 4.69	4.54	4.51	4.33
	=====	=====	=====	=====

<FN>

<FN1> Amounts reported in prior periods have been reclassified to conform with current presentation.

<FN2> Non-refinery margin includes margins on products purchased and resold, margins on products sold in markets outside of Alaska, intrasegment pipeline revenues, retail margins, and adjustments due to selling a volume and mix of products that is different than actual volumes manufactured.

<FN3> Sources of total products sales include products manufactured at the refinery, products drawn from inventory balances and products purchased from third parties. The Company's purchases of refined products for resale averaged approximately 24,700 and 13,600 barrels per day for the three months ended September 30, 1997 and 1996, respectively, and approximately 15,500 and 12,100 barrels per day for the nine months ended September 30, 1997 and 1996, respectively.

<FN4> Gross margins on total product sales include margins on sales of purchased products, together with the effect of changes in inventories.

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REFINING AND MARKETING

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.4 million from the Company's Refining and Marketing segment during the 1997 Quarter represented a 30% improvement from the 1996 Quarter. The continued success of the Company's program to sell a larger portion of its refinery production within the core Alaska market, together with generally favorable industry conditions, contributed to this improvement. The Company's sales of gasoline and asphalt in Alaska increased in the 1997 Quarter as compared to the 1996 Quarter. Jet fuel sales also increased due to growing trans-Pacific air cargo traffic through the international airport in Anchorage.

The Company's refinery product spread averaged \$5.89 per barrel in the 1997 Quarter, a \$.15 per barrel improvement from the 1996 Quarter. The Company's refined product yield values decreased by 5% to \$23.81 per barrel in the 1997 Quarter from \$25.07 per barrel in the 1996 Quarter, while the Company's feedstock costs decreased by 7% to \$17.92 per barrel in the 1997 Quarter from

\$19.33 per barrel in the 1996 Quarter. The 1997 Quarter and 1996 Quarter both included scheduled turnarounds, during which the refinery was not fully operational. Margins from non-refinery activities increased to \$10.8 million during the 1997 Quarter from \$10.0 million in the 1996 Quarter due primarily to higher retail sales and improved margins on refined products sold outside Alaska.

The increase of \$7.6 million in revenues from refined products sales during the 1997 Quarter was primarily due to higher sales volumes, which rose 5% to 70,184 barrels per day in the 1997 Quarter from 66,685 barrels per day in the 1996 Quarter. Other revenues declined by \$12.5 million due primarily to lower sales volumes of previously purchased crude oil together with lower prices. During the 1997 Quarter, the Company had less crude oil available for resale as refinery throughput averaged 2,027 barrels per day more than in the 1996 Quarter. Costs of sales decreased in the 1997 Quarter due to lower prices for crude oil and refined products. The \$1.0 million increase in operating expenses included higher employee costs associated in part with expanded marketing efforts and higher professional fees. The 1996 Quarter included a \$.7 million write-down of a West Coast terminal that was subsequently sold.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$16.3 million in the 1997 Period compares to operating profit of \$8.7 million in the 1996 Period. The Company's refinery spread of \$5.14 per barrel in the 1997 Period improved 6% from the prior year period. The Company's production of jet fuel, a product in short supply in Alaska, was higher in the 1997 Period principally due to the use of an improved catalyst in the hydrocracker unit, a change made during the refinery turnaround in the 1996 Period. Margins from non-refinery activities increased to \$27.1 million during the 1997 Period as compared to \$24.9 million in the 1996 Period due primarily to higher retail sales and improved margins on refined products sold outside of Alaska.

Revenues from sales of refined products in the Company's Refining and Marketing segment increased by 5% during the 1997 Period due to higher sales volumes and prices. Other revenues declined by \$50.0 million during the 1997 Period due primarily to lower sales volumes of crude oil together with lower prices. During the 1997 Period, the Company had less crude oil available for resale as refinery throughput averaged 2,465 barrels per day more than in the 1996 Period and fewer spot purchases of crude oil were made. Costs of sales decreased in the 1997 Period due to lower volumes of crude oil. The \$1.6 million increase in operating expenses included higher employee costs and professional fees.

FUTURE IMPACT. The improvement in Refining and Marketing results have been due in part to the Company's marketing program to sell a larger portion of its refinery production within the core Alaska market. In addition, favorable summer and fall weather conditions in Alaska increased the demand for the Company's in-state sales during the 1997 Period. In early October 1997, the Company completed an expansion of its refinery hydrocracker unit, which

increases the unit's capacity by approximately 25% to 12,500 barrels per day and enables the Company to produce more jet fuel. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of \$19 million with a projected payback period of two years and is expected to favorably impact this segment's results beginning in the fourth quarter of 1997. The Company is also expanding its Alaskan retail operations with the construction of new outlets and remodeling of existing outlets. With respect to crude oil supply, beginning in October 1997, a subsidiary of the Company has contracts to purchase all of the approximately 34,000 barrels per day of Cook Inlet production for various periods of more than one year. In the 1997 Period, the Company processed approximately 9,300 barrels per day of Cook Inlet crude, or 19% of the refinery's throughput. The increase in Cook Inlet crude oil as a refinery feedstock will enable the Company to

*Sells Crude to
Subsidiary
Ties to B-10*

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produce higher-valued products. Although the aforementioned initiatives are expected to improve the fundamental earnings potential of this segment, future profitability of this segment will continue to be influenced by market conditions, particularly as these conditions influence costs of crude oil relative to prices received for sales of refined products, and other additional factors that are beyond the control of the Company.

<TABLE>

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EXPLORATION AND PRODUCTION

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
(Dollars in millions except per unit amounts)				
<S>	<C>	<C>	<C>	<C>
U.S.<FN1><FN2>:				
Gross Operating Revenues.	\$ 15.9	23.0	53.3	73.4
Other Income (primarily retroactive severance tax refunds).	-	-	1.9	5.0
Production Costs	1.5	1.3	5.0	3.8
Administrative Support and Other Operating Expenses . . .	.6	.2	1.7	2.2
Depreciation, Depletion and Amortization.	7.0	6.2	22.2	18.9
Operating Profit - U.S..	6.8	15.3	26.3	53.5
BOLIVIA:				
Gross Operating Revenues.	3.8	3.4	8.4	10.5
Other Income (related to collection of a receivable). . .	-	-	2.2	-
Production Costs.	.3	.2	.7	.6
Administrative Support and Other Operating Expenses . . .	.5	.6	1.3	2.1

Depreciation, Depletion and Amortization.	.5	.4	1.0	1.0
	-----	-----	-----	-----
Operating Profit - Bolivia	2.5	2.2	7.6	6.8
	-----	-----	-----	-----
TOTAL OPERATING PROFIT - EXPLORATION AND PRODUCTION. . . . \$	9.3	17.5	33.9	60.3
	=====	=====	=====	=====

U.S.:

Average Daily Net Production:				
Natural gas (Mcf)	79,683	80,612	86,317	88,723
Oil (barrels)	93	39	119	15
Average Prices:				
Natural gas (\$/Mcf) -				
Spot market<FN3>. \$	2.01	1.71	2.08	1.77
Average<FN2>. \$	2.01	2.92	2.08	2.85
Oil (\$/barrel) \$	18.23	20.93	19.44	20.59
Average Operating Expenses (\$/Mcfe) -				
Lease operating expenses \$	.21	.14	.18	.12
Severance taxes.	-	.04	.03	.04
	-----	-----	-----	-----
Total Production Costs.	.21	.18	.21	.16
Administrative support	.09	.01	.07	.08
	-----	-----	-----	-----
Total Operating Expenses. \$	.30	.19	.28	.24
	=====	=====	=====	=====
Depletion (\$/Mcfe) \$	.93	.82	.92	.77
	=====	=====	=====	=====
Capital Expenditures. \$	16.3	11.7	32.5	27.1
	=====	=====	=====	=====

BOLIVIA:

Average Daily Net Production:				
Natural gas (Mcf)	26,856	20,945	18,452	21,355
Condensate (barrels)	760	605	529	611
Average Prices:				
Natural gas (\$/Mcf) \$				
	1.13	1.31	1.20	1.33
Condensate (\$/barrel) \$				
	15.00	16.92	16.23	16.50
Average Operating Expenses (\$/Mcfe) -				
Production costs \$	.10	.11	.11	.10
Value-added taxes.	-	.08	-	.07
Administrative support	.20	.24	.25	.24
	-----	-----	-----	-----
Total Operating Expenses. \$	.30	.43	.36	.41
	=====	=====	=====	=====
Depletion (\$/Mcfe) \$	.19	.17	.18	.15
	=====	=====	=====	=====
Capital Expenditures. \$	20.0	.8	26.0	5.7

=====

<FN>

<FN1> Represents the Company's U.S. oil and gas operations combined with gas transportation activities.

<FN2> Results for 1996 included revenues from above-market pricing provisions of a contract with Tennessee Gas which was terminated effective October 1, 1996. Operating profit for the three and nine months ended September 30, 1996 included \$8.5 million and \$24.6 million, respectively, for the excess of these contract prices over spot market prices. Net natural

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gas production sold under the contract averaged approximately 14 Mmcf per day for both the three months and nine months ended September 30, 1996.

<FN3> Includes effects of the Company's natural gas commodity price agreements which amounted to a loss of \$.19 per Mcf for the three months ended September 30, 1996, and losses of \$.06 per Mcf and \$.15 per Mcf for the nine months ended September 30, 1997 and 1996, respectively.

<FN4> Mcf is defined as one thousand cubic feet; Mcfe is defined as net equivalent one thousand cubic feet.

</TABLE>

EXPLORATION AND PRODUCTION - U. S.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$6.8 million from the Company's U.S. operations in the 1997 Quarter compares to operating profit of \$15.3 million in the 1996 Quarter. The 1996 Quarter included revenues from the sale of natural gas at above-market prices under a contract with Tennessee Gas. The excess of these contract prices over spot market prices contributed approximately \$8.5 million to operating profit in the 1996 Quarter. When excluding the incremental value of the Tennessee Gas contract from the 1996 Quarter, operating profit from the Company's U.S. operations for the 1997 Quarter would be relatively unchanged as total production volumes remained flat during both quarters and increases in spot market natural gas prices were offset by increased depreciation and depletion and operating expenses.

Prices realized by the Company on spot market natural gas production increased to \$2.01 per Mcf in the 1997 Quarter from \$1.71 per Mcf in the 1996 Quarter. On a weighted-average basis, the Company's natural gas sales price was \$2.92 per Mcf in the 1996 Quarter due to sales under the Tennessee Gas contract. The Company's production averaged 80.2 million cubic feet equivalents ("Mmcfe") per day in the 1997 Quarter compared to 80.8 Mmcfe per day in the 1996 Quarter. This decrease in the Company's production consisted of a 14.0 million cubic feet ("Mmcf") per day decline from the Bob West Field partially offset by a 13.4 Mmcfe per day production increase from other U.S. fields. The Company's production outside of the Bob West Field rose to 23% of total production during the 1997 Quarter, as compared to 6% in the 1996 Quarter. In September 1997, production began from the Company's interest in the Vinegarone East Field in Val

Verde Basin of Southwest Texas at an initial flow rate of approximately 12 Mmcf per day gross (8.6 Mmcf per day net). Drilling is underway on two development wells in this field. In addition, the Cuellar 1 well, which was discovered during the 1997 Quarter in the Wilcox Trend of South Texas, began production in October 1997 at 8.0 Mmcf per day gross (6.0 Mmcf per day net). The Company's net U.S. production reached 90 Mmcf per day in late October 1997.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$.2 million in the 1997 Quarter due primarily to higher per-unit lease operating expenses from the Company's newer fields. Depreciation and depletion increased by \$.8 million, or 13%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuation in the prices of natural gas in the spot market. During the 1996 Quarter, the Company used such agreements to set the price of 38% of the natural gas production that it sold in the spot market and recognized a loss of \$1.2 million (\$.19 per Mcf) related to these price agreements. The Company did not have any such transactions during the 1997 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$26.3 million from the Company's U.S. operations in the 1997 Period compares to \$53.5 million in the 1996 Period. Comparability between these periods was impacted by certain significant items. The 1996 Period included operating profit of \$24.6 million from the excess of Tennessee Gas contract prices over spot market prices. Results of operations in 1997 and future years will no longer include above-market revenues from this contract which was terminated effective October 1, 1996. Operating profit also included retroactive severance tax refunds of \$1.8 million and \$5.0 million in the 1997 and 1996 Periods, respectively. Excluding the incremental value of the Tennessee Gas contract and retroactive severance tax refunds, operating profit from the Company's U.S. operations would have been \$24.5 million in the 1997 Period compared to \$23.9 million in the 1996 Period. The resulting increase of \$.6 million was primarily attributable to higher spot market prices for sales of natural gas partially offset by higher depreciation and depletion.

Prices realized by the Company on its spot natural gas production increased 18% to \$2.08 per Mcf in the 1997 Period from \$1.77 per Mcf in the 1996 Period. The increase in average spot market prices was attributable in part to unusually high prices received during January and February when there was unusually cold weather combined with below-normal natural gas storage levels. On a weighted-average basis, the Company's natural

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gas sales price was \$2.85 per Mcf in the 1996 Period due to sales under the

Tennessee Gas contract. The Company's production averaged 87.0 Mmcfe per day in the 1997 Period, a decrease of 1.8 Mmcfe per day from the 1996 Period. This decrease in the Company's production consisted of a 13.9 Mmcfe per day decline from the Bob West Field partially offset by a 12.1 Mmcfe per day increase from other U.S. fields. Production from the Bob West Field, which accounted for 95% of the Company's total U.S. production in the 1996 Period, was reduced to 81% in the 1997 Period.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$1.2 million during the 1997 Period due to higher per-unit lease operating expenses from the Company's newer fields. Administrative support and other operating expenses decreased by \$.5 million. Depreciation and depletion increased by \$3.3 million, or 17%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuations in the prices of natural gas in the spot market. In addition, from time to time the Company has entered into price agreements with collars, under which no payments will be made by either party unless the price falls below a designated floor price or above a designated ceiling price, at which time the Company receives or pays the difference, respectively. During the 1997 and 1996 Periods, the Company used such agreements to set the price of 11% and 37%, respectively, of the natural gas production that it sold in the spot market. During the 1997 and 1996 Periods, the Company realized losses of \$1.6 million (\$.06 per Mcf) and \$2.9 million (\$.15 per Mcf), respectively, from these price agreements. At September 30, 1997, the Company has no remaining price agreements outstanding for the year.

EXPLORATION AND PRODUCTION - BOLIVIA

HYDROCARBONS LAW. In 1996, a new Hydrocarbons Law was passed by the Bolivian government that significantly impacts the Company's operations in Bolivia. The new law, among other matters, granted the Company the option to convert its Contracts of Operation to new Shared Risk Contracts. On November 6, 1997, the Company completed the conversion of its Contracts of Operation for Block 18 and Block 20 into four Shared Risk Contracts. The new contracts have an effective date of July 29, 1996 and extend the Company's term of operation, provide more favorable acreage relinquishment terms and provide for a more favorable fiscal regime of royalties and taxes. The new contract for Block 18 is extended to the year 2017. The new contracts for Block 20 are extended to the year 2029 for Block 20-West and Block 20-East, which are in the exploration phase, and to the year 2018 for Block 20-Los Suris that is in the development phase.

FARMOUT. A farmout agreement executed June 19, 1997, between the Company and Total Exploration Production Bolivie, S.A. ("Total"), an affiliate of Total S.A., became effective on a portion of Block 20-West on November 6, 1997. Pursuant to the farmout agreement, Total established a financial guarantee to

the Bolivian government to guarantee the performance of exploration work on Block 20-West. Under the farmout agreement, Total has the right to drill, at its sole cost, two exploratory wells to earn a 75 percent interest in the farmout area which consists of 315,000 acres of Block 20-West. The assignment of interest by the Company to Total, which is subject to reversion if Total does not earn the interest, has been approved by the Bolivian government and is expected to become effective in the fourth quarter of 1997. It is anticipated that Total will spud the first well by mid-1998.

YPFB AND YPF CONTRACT. The Company's Bolivian natural gas production has been sold to Yacimientos Petroliferos Fiscales Bolivianos ("YPFB"), which in turn sells the natural gas to Yacimientos Petroliferos Fiscales, SA ("YPF"), a publicly-held company based in Argentina. Currently, the Company's sales of natural gas production is based on the volume and pricing terms in the contract between YPFB and YPF. The contract to sell gas to YPF expired March 31, 1997 and a contract extension was signed effective April 1, 1997 extending the contract term two years to March 31, 1999 with an option to extend the contract a maximum of one additional year if the pipeline being constructed from Bolivia to Brazil is not complete. In the contract extension, YPF negotiated an 11% reduction in the minimum contract volume it is required to import from Bolivia, which in turn resulted in a corresponding 11% reduction of Tesoro's minimum contract volume.

ACCESS TO NEW MARKETS. A lack of market access has constrained natural gas production in Bolivia. Preliminary work on a new 1,900-mile pipeline that will link Bolivia's gas reserves with markets in Brazil has begun and the pipeline is expected to be operational in early 1999.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$2.5 million from the Company's Bolivian operations in the 1997 Quarter compares to

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operating profit of \$2.2 million in the 1996 Quarter. With the Company's purchase of Zapata's interests in Block 18 and Block 20 in July 1997, the Company now holds a 100% interest in both blocks, subject to the farmout agreement with Total (see Note 2 of Notes to Condensed Consolidated Financial Statements). Beginning in the 1997 Quarter, the Company's net share of production from Block 18 increased by approximately 33% as a result of this purchase. Block 20 is currently shut-in waiting on the construction of the pipeline to Brazil, which is expected to be operational in early 1999. Natural gas prices for Bolivian production fell to \$1.13 per Mcf in the 1997 Quarter, a 14% drop from the 1996 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.6 million from the Company's Bolivian

operations in the 1997 Period compares to operating profit of \$6.8 million in the 1996 Period. The 1997 Period included income of \$2.2 million related to the collection of a receivable for prior years production. Excluding this income, operating profit would have decreased by \$1.4 million as production of natural gas and condensate fell by 14%. As discussed above, the Company's production rose during the 1997 Quarter due to the purchase of the Zapata interests in July 1997 which will also benefit future periods. However, earlier in the year, the Company's Bolivian natural gas production was lower due to a reduction in minimum takes under the new contract between YPFB and YPF and also due to constraints arising from repairs to a non-Company-owned pipeline that transports gas from Bolivia to Argentina. A replacement pipeline is now operational, which has restored full capacity. During the 1996 Period, production was higher due to requests from YPFB for additional production from the Company to meet export specifications. Natural gas prices declined to \$1.20 per Mcf in the 1997 Period compared to \$1.33 per Mcf in the 1996 Period. Administrative support and other operating expenses decreased by \$.8 million in the 1997 Period due primarily to the reduced production levels.

<TABLE>

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MARINE SERVICES

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in millions)	1997	1996	1997	1996
	----	----	----	----
<S>	<C>	<C>	<C>	<C>
Gross Operating Revenues:				
Fuels	\$ 25.2	26.0	77.6	70.4
Lubricants and other.	4.2	4.1	12.3	10.9
Services.	3.1	2.6	8.4	6.2
	----	----	----	----
Gross Operating Revenues	32.5	32.7	98.3	87.5
Costs of Sales	22.9	24.5	72.6	66.7
	----	----	----	----
Gross Profit	9.6	8.2	25.7	20.8
Operating Expenses and Other	6.5	5.8	20.4	15.4
Depreciation and Amortization.	.4	.4	1.2	.9
	----	----	----	----
Operating Profit	\$ 2.7	2.0	4.1	4.5
	=====	=====	=====	=====
Sales Volumes (millions of gallons):				
Fuels, primarily diesel	39.1	37.8	116.2	107.4
Lubricants.	.7	.7	2.0	1.9
Capital Expenditures	\$ 2.0	1.2	5.3	6.2

</TABLE>

For the 1997 Quarter, gross operating revenues declined by \$.2 million due primarily to lower fuel sales prices partly offset by increased fuel volumes. The \$1.6 million decrease in cost of sales correlates to these lower fuel market prices. The 19% increase in service revenues was associated with the increased rig activity in the Gulf of Mexico and the Company's focus to serve these customers. The improvement of \$1.4 million in gross profit was partly offset by higher operating expenses associated with the increased sales volumes and service revenues.

For the 1997 Period, gross operating revenues increased by \$10.8 million, with an 11% increase in fuels and lubricants revenues and a 35% increase in service revenues. These increases were mainly due to added locations and associated volumes stemming from an acquisition consummated in February 1996 together with internal growth initiatives. Costs of sales during the 1997 Period increased due to the higher volumes and also included a \$.7 million charge associated with inventory valuations as market prices declined from year-end levels. The improvement of \$4.9 million in gross profit during the 1997 Period was offset by higher operating and other expenses associated with the increased activity and upgrades to facilities and services.

The Marine Services segment's business is largely dependent upon the volume of oil and gas drilling, workover, construction and seismic activity in the Gulf of Mexico.

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GENERAL AND ADMINISTRATIVE

General and administrative expense increased by \$.3 million and \$.6 million during the 1997 Quarter and Period, respectively. These increases were primarily due to higher employee costs partially offset by reduced professional fees and insurance costs.

INTEREST EXPENSE AND INTEREST INCOME

Interest expense decreased by \$2.6 million and \$7.5 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to the Company's redemption of \$74.1 million of public debt in November 1996 which has resulted in interest expense savings of approximately 60% in the 1997 Quarter and Period.

Interest income decreased by \$6.9 million and \$6.2 million during the 1997 Quarter and Period, respectively. The 1996 Quarter and Period included interest of approximately \$7 million received from Tennessee Gas in conjunction with the collection of a receivable which resulted from underpayment for natural gas sold

in prior periods. The 1997 Period included interest income of approximately \$.4 million related to the collection of a Bolivia receivable.

OTHER EXPENSE, NET

For the 1997 Period, other expense decreased by \$5.3 million primarily due to charges incurred in the prior year period for shareholder consent solicitation costs of \$2.3 million, which was resolved in April 1996, together with a write-off of deferred financing costs and employee termination costs with no material comparable costs recorded in the current period.

INCOME TAX PROVISION

Income taxes decreased by \$2.2 million and \$2.8 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to lower earnings.

IMPACT OF CHANGING PRICES

The Company's operating results and cash flows are sensitive to the volatile changes in energy prices. Major shifts in the cost of crude oil used for refinery feedstocks and the price of refined products can result in a change in margin from the Refining and Marketing operations, as prices received for refined products may or may not keep pace with changes in crude oil costs. These energy prices, together with volume levels, also determine the carrying value of crude oil and refined product inventory. The Company uses the last-in, first-out ("LIFO") method of accounting for inventories of crude oil and U.S. wholesale refined products. This method results in inventory carrying amounts that are less likely to represent current values and in costs of sales which more closely represent current costs.

Likewise, changes in natural gas, condensate and oil prices impact revenues and the present value of estimated future net revenues and cash flows from the Company's Exploration and Production operations. The Company may increase or decrease its production in response to market conditions. The carrying value of oil and natural gas assets may be subject to noncash writedowns based on changes in natural gas prices and other determining factors.

Changes in natural gas prices also influence the level of drilling activity in the Gulf of Mexico. The Company's Marine Services operation, whose customers include offshore drilling contractors and related industries, could be impacted by significant fluctuations in natural gas prices. The Company's Marine Services segment uses the first-in, first-out ("FIFO") method of accounting for its inventories of fuel. Changes in fuel prices can significantly impact inventory valuations and costs of sales in this segment.

CAPITAL RESOURCES AND LIQUIDITY

OVERVIEW

The Company's primary sources of liquidity are its cash and cash equivalents, internal cash generation and external financing. During the first nine months of 1997, the Company made capital expenditures exceeding \$95 million, which were funded through a combination of cash flows from operations of \$71 million, external financing of \$16 million and available cash balances. Subsequently, in October 1997, the Company obtained a \$16.2 million term loan to finance the expansion of the refinery hydrocracker unit (see Note 3 of Notes to Condensed Consolidated Financial Statements). At September 30, 1997, the Company's debt-to-capitalization ratio was 22% which enhances the Company's ability to access capital markets.

The Company is focused on its strategic plans to make operational improvements and continues to assess its asset base in order to maximize returns and develop full value through strategic diversification and acquisitions in all of its operating segments. This ongoing assessment includes, in the Exploration and Production segment, evaluating ways in which the Company could diversify its oil and gas reserve base and offset the impact of declining production through domestic development, exploration and acquisition outside of the Bob West Field. In the Refining and Marketing segment, the Company has been engaged in studies to improve profitability and has also evaluated possible joint ventures, strategic alliances or business combinations; such evaluations have not resulted in any significant transaction but operating strategies have been implemented to optimize the product and feedstock slates, improve efficiencies and reliability, and expand marketing to increase placement of products in Alaska. In the Marine Services segment, the Company continues to pursue opportunities for expansion as well as optimizing existing operations.

The Company operates in an environment where its liquidity and capital resources are impacted by changes in the supply of and demand for crude oil, natural gas and refined petroleum products, market uncertainty and a variety of additional risks that are beyond the control of the Company. These risks include, among others, the level of consumer product demand, weather conditions, the proximity of the Company's natural gas reserves to pipelines, the capacities of such pipelines, fluctuations in seasonal demand, governmental regulations, the price and availability of alternative fuels and overall market and economic conditions. The Company's future capital expenditures as well as borrowings under its credit arrangements and other sources of capital will be affected by these conditions.

STOCK REPURCHASE PROGRAM

On May 7, 1997, the Company's Board of Directors authorized the repurchase of up to 3 million shares (approximately 11% of the current outstanding shares) of Tesoro Common Stock in a buyback program that will extend through the end of

1998. Under the program, subject to certain conditions, the Company may repurchase from time to time Tesoro Common Stock in the open market and through privately negotiated transactions. Purchases will depend on price, market conditions and other factors and will be made primarily from cash flows. The repurchased Common Stock is accounted for as treasury stock and may be used for employee benefit plan requirements and other corporate purposes. Repurchases of Common Stock are subject to the restricted payments provision of the Credit Facility as described below.

CREDIT ARRANGEMENTS

The Company has financing and credit arrangements with a consortium of nine banks under a corporate revolving credit agreement ("Credit Facility") which provides total commitments of \$150 million. The Credit Facility, which extends through April 2000, provides for cash borrowings up to \$100 million and issuance of letters of credit, subject to a borrowing base (which was approximately \$147 million at September 30, 1997). The Company, at its option, has currently activated total commitments of \$100 million. Outstanding obligations under the Credit Facility are secured by liens on substantially all of the Company's trade accounts receivable and product inventory and by mortgages on the Company's refinery and South Texas natural gas reserves. Under the terms of the Credit Facility, the Company is required to maintain specified levels of consolidated working capital, tangible net worth, cash flow and interest coverage. Among other matters, the Credit Facility contains covenants which limit the incurrence of additional indebtedness and restricted payments. An amendment to the Credit Facility, which was negotiated in September 1997, reduces interest rates and certain fees, increases the Company's borrowing base and makes certain covenants less restrictive. Additionally, the Company is now

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permitted to utilize unsecured letters of credit outside of the Credit Facility up to \$40 million (none outstanding at September 30, 1997). Under the Credit Facility, the Company had letters of credit of \$33.9 million, primarily for royalty crude oil purchases from the State of Alaska, and cash borrowings of \$11.9 million outstanding at September 30, 1997.

The terms of the Credit Facility allow for open market stock repurchases and the payment of cash dividends subject to a cumulative amount available for restricted payments (defined as the difference of (i) the sum since December 31, 1995, of (a) \$5 million and (b) 50% of consolidated net earnings of the Company in any calendar year and (ii) any restricted payments made since June 1996). At September 30, 1997, the cumulative amount available for restricted payments was approximately \$54 million. Annually, however, the aggregate of open market stock repurchases and cash dividends cannot exceed a maximum of \$5 million. In addition, the Credit Facility permits the Company to repurchase a limited amount of Common Stock up to \$10 million annually, specifically for oddlot buyback

programs and employee benefit or compensation plans. While the Board of Directors has no present plans to pay dividends, from time to time the Board of Directors reevaluates the feasibility of declaring future dividends.

In addition to the Credit Facility, a subsidiary of the Company has a three-year line of credit with a bank which provides up to \$10 million for the purchase of real estate and equipment for the Company's Marine Services segment at the bank's prime rate. The loan facility is not guaranteed by the Company and is secured only by such real estate and equipment that are financed. Beginning in March 1998, credit availability is reduced quarterly by 6.667%. At September 30, 1997, \$ 4.8 million was outstanding under the loan facility.

In early October 1997, the Company completed an expansion of the hydrocracker unit at its Alaska refinery. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of approximately \$19 million and is expected to improve the Company's refinery feedstock and product slate beginning in the fourth quarter of 1997. In October 1997, the National Bank of Alaska ("NBA") and the Alaska Industrial Development and Export Authority ("AIDEA"), under a loan agreement ("Hydrocracker Loan") entered into between the Company and NBA, provided a \$16.2 million loan to the Company towards the cost of the hydrocracker expansion. The Hydrocracker Loan matures on or before April 1, 2005 and is secured by a second lien on the refinery. Under the terms of the Hydrocracker Loan, the Company is required to maintain specified levels of working capital and tangible net worth. See Note 3 of Notes to Condensed Consolidated Financial Statements.

CAPITAL SPENDING

During the first nine months of 1997, the Company's capital expenditures totaled \$95 million which were financed with available cash reserves, internally-generated cash flows from operations and external financing. In addition, the Company has obtained outside financing, as discussed above, for expansion of the refinery hydrocracker unit. Although capital expenditures for the remainder of the year had been projected to reach \$65 million, actual capital spending will be less due to a number of factors, including the extent to which properties are acquired and the timing of capital projects. Capital expenditures for the remainder of the year are expected to be funded by cash flows from operations and external borrowings under the Company's credit arrangements.

The Exploration and Production segment accounts for \$101 million of the projected capital expenditures, with \$71 million planned for U.S. activities and \$30 million in Bolivia. Planned U.S. expenditures include \$22 million for property acquisitions; \$17 million for development drilling (participation in 16 wells), field facilities and workovers; \$13 million for leasehold, geological and geophysical; and \$19 million for exploratory drilling (participation in 14 wells). For the first nine months of 1997, actual U.S. expenditures were \$32 million, principally for participation in the drilling of five development wells

(all completed) and nine exploratory wells (seven completed). In Bolivia, projected capital expenditures of \$30 million for the year included an increase for the purchase of additional contract interests in July 1997 (see Note 2 of Notes to Condensed Consolidated Financial Statements). The projection in Bolivia includes \$3 million for one exploratory well and \$2 million for workovers and field facilities, with the remainder planned for three-dimensional seismic. Capital spending for the first nine months of 1997 totaled \$26 million in Bolivia, primarily for the purchase of additional contract interests, exploratory drilling, seismic activity and workovers. Although the Company continues to pursue exploratory, development and acquisition opportunities, as discussed above, actual capital expenditures for the remainder of the year may vary from projections.

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Capital spending for the Refining and Marketing segment is projected to be \$50 million for the year, including costs for the refinery hydrocracker expansion and a multi-year capital program to improve marketing operations. During the first nine months of 1997, the Refining and Marketing segment had spent approximately \$31 million towards capital projects.

In the Marine Services segment, capital spending for 1997 is currently projected at \$8 million, a \$21 million reduction from the original budget. This projection, of which \$5 million was spent during the first nine months of 1997, is now primarily directed towards expansion and improvement of operations along the Gulf of Mexico rather than acquisitions.

CASH FLOWS

Components of the Company's cash flows are set forth below (in millions):

<TABLE>

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Nine Months Ended
September 30,

1997 1996

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Cash Flows From (Used In):

Operating Activities	\$	71.1	148.4
Investing Activities		(98.2)	(57.0)
Financing Activities		11.7	(1.8)
		-----	-----
Increase (Decrease) in Cash and Cash Equivalents .	\$	(15.4)	89.6
		=====	=====

</TABLE>

Operating cash flows of \$71 million during the 1997 Period included a \$46 million decrease in receivables due in part to collections related to high product and crude oil sales volumes at 1996 year-end and to a Bolivian receivable representing production sold in prior years, partially offset by income tax and other payments. The 1996 Period operating cash flows of \$148 million included a \$67.5 million receipt from Tennessee Gas and reduced working capital requirements. Net cash used in investing activities of \$98 million during the 1997 Period included capital expenditures of \$58 million for the Company's Exploration and Production activities, \$31 million for Refining and Marketing operations and \$5 million for Marine Services. Net cash from financing activities during the 1997 Period included borrowings of \$16 million under revolving credit facilities partially offset by payments of other long-term debt and purchases of treasury stock. At September 30, 1997, the Company's net working capital totaled \$76 million, which included cash and cash equivalents of \$7 million.

ENVIRONMENTAL

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, which change frequently, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites or install additional controls or other modifications or changes in use for certain emission sources. The Company is currently involved in remedial responses and has incurred cleanup expenditures associated with environmental matters at a number of sites, including certain of its own properties. At September 30, 1997, the Company's accruals for environmental expenses amounted to \$8.7 million, which included a noncurrent liability of \$3.1 million for remediation of KPL's properties that has been funded by the former owners of KPL through a restricted escrow deposit. Based on currently available information, including the participation of other parties or former owners in remediation actions, the Company believes these accruals are adequate. In addition, to comply with environmental laws and regulations, the Company anticipates that it will make capital improvements of approximately \$3 million in 1997 and \$8 million in 1998. The Company also expects to spend approximately \$6 million by the year 2002 for secondary containment systems for existing storage tanks in Alaska.

Conditions that require additional expenditures may exist for various Company sites, including, but not limited to, the Company's refinery, retail gasoline outlets (current and closed locations) and petroleum product terminals, and for compliance with the Clean Air Act. The amount of such future expenditures cannot currently be determined by the Company. For further information on environmental contingencies, see Note 4 of Notes to Condensed Consolidated Financial Statements.

POLAR MINING INC

4545 Wood River Dr.
Fairbanks, Alaska. 99709
Mine Phone 907-455-4198, Fax 907-455-8245

March 19, 1998

Representative Jerry Sanders
Room 414 State Capitol
Juneau, Alaska. 99811

Dear Sir:

I understand you are conducting a teleconference today to investigate fuel pricing. Though I am unable to attend I would like to have my comments included as part of the testimony received.

I am the President and General Manager of Polar Mining Inc, a family owned and operated mining company operating year round in the Fairbanks area over the past 20 years. We employ up to 40 employees, with seasonal variations, and have been dramatically effected by last years 20% decrease in gold prices. Last season we consumed 800,000 gals of diesel fuel at our mine and this is a significant part of our total operating expenses.

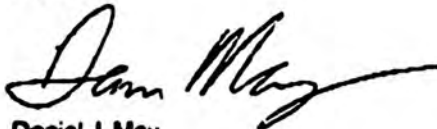
It has come to my attention that there exists a large price difference between fuel refined in North Pole and available for sale to Fairbanks consumers versus the same fuel transported to Anchorage and available to consumers there. In fact recent charting has shown the oil from the north slope can be transported to Washington, refined and sold there for \$0.27 gallon less than the same product sells for in Fairbanks. (based on rack prices of #2 Diesel as of 2/1/98)

It is my understanding that #1 diesel fuel produced @ Mapco's North Pole Refinery can be transported to Anchorage at a cost of approx. \$0.06/ gal, and then sells off the rack in Anchorage @ \$0.53/gal. plus tax. The cost to transport this same fuel back to Fairbanks via independent trucker is \$0.105 that would make this double hauled fuel cost \$0.64 returned to Fairbanks. This is still 12 to 14 cents a gallon less than the current Fairbanks rack price for this product. If this information is correct there is some serious gouging taking place to the local consumer.

I tried to confirm this pricing by calling MAPCO Fairbanks, where I was directed to MAPCO Anchorage. My voice mail message of 3/16/98 to the Anchorage MAPCO marketing office in which I asked for posted rack pricing for #1 Diesel at both Fairbanks and Anchorage has yet to be answered.

I have confined my comments to diesel fuel pricing as that affects me the most. However the same discrepancy exists across the product line and the local consumers appear to be paying extra to line the pockets of this out of state company. I understand that part of the statute that allowed the sale of Alaska's royalty oil to the refinery calls for fair pricing, and I do applaud your investigation into this matter.

Sincerely,



Daniel J. May
President

April 22, 1998

Representative Jerry Sanders
Chairman, Economic Development Committee
State Capitol
Juneau, AK 99811

Dear Representative Sanders:

I applaud your efforts to examine the relationship between crude oil prices and petroleum product prices in Alaska. Bringing down the cost of air, land and water transportation, remote diesel power generation, space heating, and fishing, construction and mining activities will due much to further economic development throughout Alaska.

Please consider the following data:

1. Alaskan refineries experienced increased profit margins in 1997.
 - a. MAPCO'S Fourth Quarter 1997 Earnings Report (attachment 1) states: "The Alaskan refinery experienced a margin increase on processed barrels sold of 45 percent over the prior year."
 - b. TESORO'S 1997 Earnings Report (attachment 2) states "The unit achieved higher margins on refined products through increased sales within its core, Alaska market".
2. At crude costs of \$12.47/bbl and gasoline pump prices of \$1.10/gallon, California refiners operate on a margin of \$0.22/gallon (attachment 3). At the same crude costs and pump prices of \$1.24/gallon, Alaska refiners operate on a gasoline margin of \$0.50-\$0.60/gallon. (attachment 4)
3. Alaska's in-state refiners are moving to capitalize on increased demand in Alaska for jet fuel.
 - a. In the fourth quarter 1997, TESORO completed expansion of their hydrocracker to produce 25% more jet fuel.
 - b. MAPCO is midway through an expansion to increase jet fuel production by 14,000 bbl/day to 35,000 bbl/day.
4. Clearly and justifiably so, these expansion plans reflect the expectation to produce additional jet fuel into the Alaskan market at a profit. With recent Anchorage jet fuel prices in the \$0.50 to \$0.60/gallon range, and with crude costs in the \$0.30/gallon range, the in-state refiners apparently believe they can make a profit at a refinery margin in the range of \$0.20-\$0.30/gallon.

5. In major markets in the U.S., gasoline does not wholesale at significantly higher prices than jet fuel (attachment 5). Yet in Alaska, gasoline wholesales for significantly more than jet fuel.

Are the in-state refiners making a larger margin on local gasoline sales than on jet fuel? If so, why should international air carriers be major beneficiaries of in-state refining when Alaskan's are less so?

Apparently, the proximity of the Anchorage jet fuel market to marine transportation makes for a large volume, competitive environment where in-state refiners must compete with other suppliers. This is not the case in many other markets in Alaska, especially considering the consolidations, vertical integrations, and product swaps that have occurred in the industry in the last few years.

Make no mistake, Alaska's in-state refiners are good for Alaska. They are an excellent example of how value added processing can provide hundreds of millions of dollars of vital economic activity. These companies make major contributions to the communities in which they operate and provide much needed economic diversification.

Indeed, the challenge you face is how to encourage this in-state refining in a manner that also fosters increased in-state competition, thereby complying with the intent of AS 38.05.183(e)(4) to "provide refined products or by-products for distribution and sale in the state with price or supply benefits to the citizens of the state".

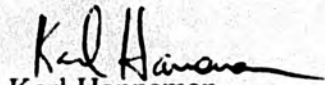
An open dissemination of product price information would help improve the efficiency of the Alaskan markets. Such information is not presently readily available to the citizens of the state, as the refineries are not always able to discuss pricing policies, even with some gasoline retailers. (see testimony to Alaska Royalty Oil & Gas Development Advisory Board, House & Senate Journal Supplement No. 16.)

To encourage more efficient markets and to help fulfill the statutory objective, I suggest that the Department of Revenue add comparative jet fuel and gasoline wholesale prices for Anchorage and Anacortes, Washington to their excellent web site that already tracks crude oil prices (www.revenue.state.ak.us/). This price information is readily available from the Oil Price Information Service (OPIS) for a few thousand dollars per year which, although beyond the reach of the average consumer, is very reasonably priced for a producer state like Alaska. Anacortes is a logical choice because refiners in that area utilize Alaska North Slope crude for feedstock and it is the closest competitive port to Alaska. Anchorage is an acceptable first step, as it is the only Alaskan city that is

currently tracked by the commercial services. An excellent example of how this information could be disseminated is located at the State of California website at www.energy.ca.gov/fuels (attachment 6).

The in-state refiners have pledged to maintain sensitivity and fairness toward the Alaskan consumer. Please assist them in this difficult task by supporting a website that provides an open flow of petroleum product price information for the benefit of all Alaskans.

Respectfully submitted,



Karl Hanneman

626 Second Street, Suite 201
Fairbanks, Alaska 99701

cc: Interior Delegation
Fairbanks North Star Borough Assembly

1

quarter operating profit of \$23.9 million in 1997, compared to \$23.0 million for the same period in 1996.

The Alaska refinery experienced a margin increase on processed barrels sold of 45 percent over the prior year and a total sales volume increase of 6 percent, due largely to an increase in jet fuel sales.

At the Memphis Refinery, a lower margin environment during the fourth quarter more than offset record throughput of 118,000 barrels per day. On Jan. 19, 1998, the refinery started production of an incremental 2,000 barrels per day of refinery-grade propylene and will increase production by another 2,000 barrels per day by the end of 1998.

MAPCO'S RETAIL PETROLEUM BUSINESS, MAPCO Express, which markets petroleum products and other merchandise through a network of 252 convenience stores and interstate travel centers, had an operating loss of \$0.5 million for the fourth quarter of 1997 compared to operating profit of \$4.7 million for the same period in 1996.

Fourth quarter results were affected by slightly lower gasoline sales per store, combined with higher per store operating expenses related predominately to implementing strategic growth plans and a \$1.6 million environmental accrual.

MAPCO Express is planning a major growth initiative in its interstate highway presence. The Company expects to open 20 new travel centers during 1998.

OTHER BUSINESSES, which include FleetOne and TouchStar Technologies, are in various stages of development. On a combined basis, these businesses reported a fourth quarter 1997 operating loss of \$4.2 million.

All earnings per share amounts contained herein are reported on a diluted basis in accordance with Statement of Financial Accounting Standards No. 128 "Earnings Per Share."

Statements contained herein, other than matters of historical fact, are forward-looking statements and are made based upon management's expectations and beliefs concerning future developments and their potential effect on the Company. There can be no assurance that future developments will be in accordance with management's expectations or that the effect of future developments on the Company will be those anticipated by management. Among the factors that could cause actual results to differ materially from such forward-looking statements are changes in the regulatory, economic, competitive, or climatic conditions in strategic areas of the Company's operations.

MAPCO press releases are also available on the World Wide Web at <http://www.mapcoinc.com>.

MAPCO INC. OPERATING STATISTICS

	Three Months Ended		Twelve Months Ended	
	December 31,		December 31,	
	1997	1996	1997	1996
NATURAL GAS LIQUIDS				

#2



Quotes & News

Quote, News & Company Digest

Agreement

QUOTES

Quote, News & Digest

Multiple Quotes

Industry Quotes

Quote Bank

Rateboard

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MODEL PORTFOLIO

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NEWS

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* Please note: both stock and option quotes may be retrieved using stock symbols.

PR NewsWire

Tesoro's Earnings Double From Normalized Prior Year

SAN ANTONIO, Jan. 29 /PRNewswire/ -- Tesoro Petroleum Corporation (NYSE: TSO) today announced net earnings for 1997 had doubled compared with 1996 when excluding certain nonrecurring items from the prior year. Net earnings for 1997 were \$30.7 million, or \$1.16 per share, compared with a normalized \$13.9 million, or 53 cents per share, in 1996.

Reported net earnings in 1996 were \$74.5 million, or \$2.87 per share, which included the effects of an above-market-price natural gas sales contract, which was terminated at the end of 1996.

"Since our earnings were not supported by a high-priced gas contract, these results show significant progress toward our goal of improving the profitability of our assets," said Chairman, President and CEO Bruce Smith. "Our downstream operations doubled in profitability, and the upstream segment increased reserves through a combination of acquisitions and an aggressive exploration program."

Downstream Operations More Than Double Operating Profit

While total downstream profit doubled in 1997, operating profit for Tesoro's Refining and Marketing segment more than tripled from 1996, reaching \$20.5 million. R&M's operating profit in 1996 was \$6.0 million. The unit achieved higher margins on refined products through increased sales within its core, Alaska market and through operating improvements.

Operational modifications implemented during 1997 greatly contributed to the profit improvement. The Company's Kenai, Alaska, refinery had scheduled turnarounds in both 1997 and 1996. The 1997 turnaround expanded the plant's hydrocracker, which allowed increased jet fuel production starting in the fourth quarter.

The Company's Marine Services segment had operating profit of \$6.3 million, up from \$6.1 million in 1996. Operating improvements made in the first half of the year resulted in improved returns in the last six months of 1997. The segment opened two new facilities in its Gulf of Mexico service area at Intracoastal City, Louisiana, and Houston.

Exploration and Production Increases Acreage, Opens New Field

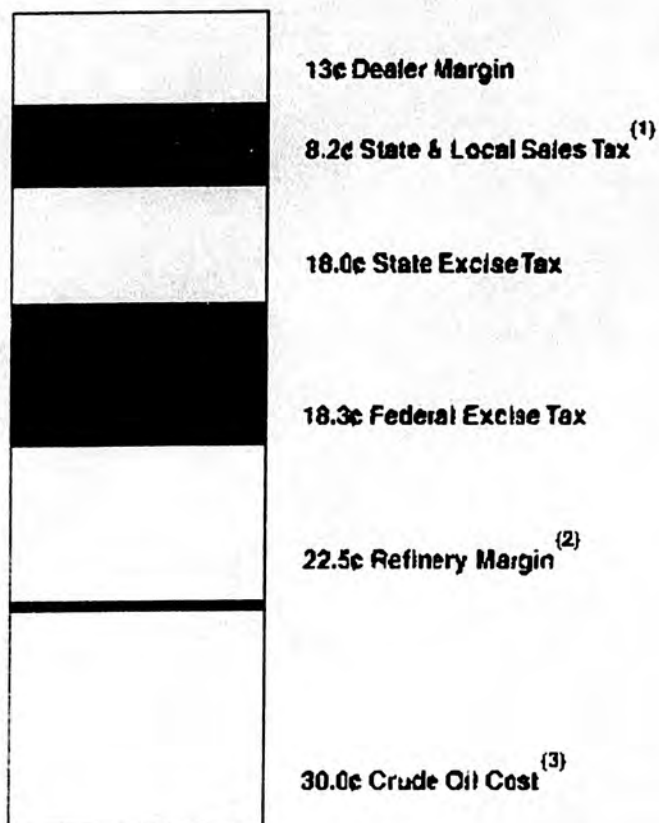
Operating profit for Exploration and Production was \$45.9 million in 1997, compared with \$48.1 million in 1996 after excluding the impact of the above-market-price natural gas sales contract.

California Motor Gasoline Price Breakdown

3

Many factors influence the price of gasoline. The figures below are based on a gallon of California reformulated regular unleaded gasoline costing **\$1.10 per gallon**, with Alaska North Slope crude oil costing **\$12.47 per barrel**. Prices will vary depending on geographical location, competition among gasoline stations, local taxes, refiner and dealer margins, transportation costs, etc.

Based on a California Reformulated Unleaded Regular gasoline costing \$1.10 and ANS crude oil costing \$12.47 per barrel.



Notes:

1. Using state and local sales tax totaling 8%. Other localities' sales tax may vary.
2. Refinery margin includes all costs associated with production and distribution of gasoline including refining and terminal operation, crude processing, oxygenate additives, product shipment and storage, oil spill prevention fees, depreciation, brand advertising and profits.
3. Crude oil prices fluctuate daily causing a change of 2.4 cents per gallon in the crude cost for gasoline for every \$1.00 per barrel change in crude oil cost.

Note: Crude oil and wholesale price changes may not be reflected immediately in the retail price of gasoline.

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E-mail us at: energia@energy.ca.gov
"Energia" means ENERGY in Greek and Latin.

4

Based on Unleaded Regular gasoline costing
Alaska North Slope Crude costing

1.24 /gallon and
12.47 /barrel

Typical Fairbanks Scenario

\$	0.12	Dealer Margin
\$	0.08	State Tax
\$	0.18	Federal Tax
\$	0.51	Refinery Margin
\$	0.30	Crude Oil Cost
\$	0.05	Quality Bank Penalty
\$	1.24	

Typical Anchorage Scenario

Nov 1 - Mar 1 (gasahol)

\$	0.12	Dealer Margin
\$	0.02	State Tax
\$	0.18	Federal Tax
\$	0.62	Refinery Margin
\$	0.30	Crude Oil Cost
\$	1.24	

Utility Purchases Another Heating Oil Firm

Providence Energy, the first East Coast utility to enter the heating oil distribution business, has just made another acquisition.

The company just bought a small Providence-based heating oil retailer, Izzy Oil, adding an estimated 500,000 gal of residential heating oil business.

Sources tell OPIS that the company is eyeing a much more substantial acquisition which could be completed this quarter. Future purchases will be focused on residential, rather than commercial/industrial business, we are told.

Providence Energy was the first utility to acquire an oil firm, buying Warwick, R.I.-based Super Service last fall. Super Service had a heavy concentration on the commercial side with 25 million gals of heating oil, diesel, gasoline and lubricants business. Super Service had about 2,600 residential customers. Providence Energy also bought Johnston, R.I.-based Mohawk Oil, which gave it some 1,500 residential heating oil customers in the Providence metro area.

The utility now has about 3,000 residential customers and delivers about 27.5 million gal annually of oil to

commercial customers.

A number of utilities have recently forged alliances with wholesalers who have a niche delivering fuel to industry. But the companies that Providence Energy is targeting are full margin retail companies, particularly in areas like Rhode Island where rack-to-retail differentials have remained substantial. The company will ultimately bundle electricity sales to those customers, but such sales look to be at least a couple of years away, at least in Rhode Island.

The utility also has kept downstream oil sales personnel intact, recognizing that the "high touch personal service can't be replicated" by a large utility, a source told OPIS.

Petroleum asset brokers say that the emergence of utilities as buyers in the retail heating oil business has led some marketers to overvalue their businesses this spring. Last year's \$1.00 gal-plus sales for retail gallons may not be achieved because of the rough winters that some major consolidators have experienced, they add.

One edge for utilities on the buy side: they can structure deals so that retailers can get high yield "safe"

N.Y. Harbor Spot Barge Daily Diary

	FRIDAY (04/03)	MONDAY (04/06)	TUESDAY (04/07)	WEDNESDAY (04/08)	THURSDAY (04/09)	WK AVG.
No.2	43.50-44.50	42.50-43.75	42.00-42.50	41.75-42.75	42.75-43.25	42.925
No.2#	44.75-45.75	44.00-45.00	43.50-44.00	43.25-44.25	44.00-44.65	44.315
Mid.	48.75-49.75	46.75-48.75	46.25-46.75	46.50-47.50	46.25-47.75	47.500
Unl.	46.50-47.50	44.75-46.50	44.25-44.75	44.50-45.50	44.25-45.75	45.425
Pre.	52.25-53.25	49.75-52.25	49.25-49.75	49.50-50.50	49.50-50.75	50.675
Jet 54	44.75-45.75	44.25-45.25	43.75-44.25	43.50-44.25	44.25-44.75	44.475
RFG Unl.	49.00-50.00	47.25-49.00	46.50-47.00	46.75-47.75	46.25-47.50	47.700
RFG Mid.	51.00-52.00	49.00-50.50	48.25-48.75	48.50-49.50	48.25-49.50	49.525
RFG Pre.	53.75-54.75	51.75-53.00	50.75-51.25	51.00-52.00	51.00-52.25	52.150
55Ker/Jet	45.15-46.15	44.50-45.50	44.00-44.50	43.75-44.50	44.75-45.25	44.805

Gulf Coast Spot Pipeline Daily Diary

	(04/03)	(04/06)	(04/07)	(04/08)	(04/09)	
No.2	40.65-41.65	40.15-41.45	40.00-40.50	39.75-40.75	40.75-41.25	40.690
No.2#	41.85-42.85	41.25-42.25	41.00-41.50	41.00-41.75	42.00-42.50	41.795
Mid.	47.25-48.25	44.25-46.50	44.00-44.50	43.50-44.75	44.75-46.25	45.400
Unl.	45.50-46.50	42.50-44.75	42.00-42.75	41.50-42.75	42.75-44.25	43.525
Pre.	50.00-51.00	47.00-49.25	46.75-47.25	46.50-47.75	47.75-49.25	48.250
Jet 54	41.50-42.50	41.35-42.35	41.00-41.50	40.75-41.75	41.75-42.25	41.670
RFG Unl.	50.25-51.25	48.25-50.00	47.50-48.25	44.75-46.00	46.00-47.50	47.975
RFG Mid.	52.00-53.00	50.00-51.75	49.25-50.25	46.75-48.00	48.00-49.50	49.850
RFG Pre.	54.50-55.50	52.75-54.50	51.75-53.00	49.75-51.00	51.00-52.50	52.625
7.8 Unl.	46.50-47.50	44.00-45.75	43.25-43.75	42.50-43.75	44.00-45.50	44.650
7.8 Mid.	51.00-52.00	48.50-50.25	47.75-48.50	47.50-48.75	49.00-51.50	49.475
7.8 Pre.	48.25-49.25	45.75-47.50	45.00-45.75	44.50-45.75	46.00-48.00	46.575
55Ker/Jet	42.25-43.25	41.50-42.50	41.00-41.50	41.00-42.00	42.00-42.50	41.950

Group 3 Spot Pipeline Daily Diary

	(04/03)	(04/06)	(04/07)	(04/08)	(04/09)	
No.2	45.50-46.50	45.00-46.00	45.00-45.50	45.00-46.00	46.15-46.65	45.730
No.2#	46.00-47.00	45.50-46.75	45.25-45.75	45.00-46.00	46.25-46.75	46.025
Unl.	48.25-49.25	46.50-48.25	46.00-46.50	46.00-47.25	46.75-47.45	47.220
Pre.	51.00-52.00	49.25-51.00	48.75-49.25	49.00-50.25	49.75-50.65	50.090

Chicago Spot Pipeline Daily Diary

	(04/03)	(04/06)	(04/07)	(04/08)	(04/09)	
No.2	42.35-43.35	42.00-42.75	42.00-42.60	42.25-43.50	43.75-44.25	42.880
No.2#	44.65-45.65	44.25-45.00	44.00-44.50	44.00-45.00	45.15-45.65	44.785
Mid.	48.25-49.25	47.50-49.00	47.50-48.25	47.50-48.75	48.50-49.25	48.375
Unl.	46.25-47.25	45.25-47.00	45.00-45.75	45.00-46.00	45.75-46.50	45.975
Pre.	51.25-52.25	51.00-52.00	51.25-51.75	51.25-53.00	52.75-53.50	52.000
Jet 54	44.75-45.75	44.35-45.35	43.75-44.25	43.50-44.75	44.50-45.00	44.595
RFG Unl.	49.00-50.00	48.00-49.75	48.00-48.75	48.00-49.00	48.75-49.50	48.875
RFG Mid.	50.50-51.50	49.50-51.25	49.50-50.25	49.75-50.75	50.50-51.25	50.475
RFG Pre.	53.00-54.00	52.00-53.75	52.00-52.75	52.50-53.50	53.25-54.00	53.075

#low sulfur
(0.05%)
*oxy-blend
prices,
HTBE
low sulfur
55 grade
jet
kerosene

utility stock as payment for their companies. The utilities can also pay for acquisitions via annuities that are backed by financially sound holding companies.

Other utilities which have purchased or allied themselves with oil firms this winter include AllEnergy (Pal Oil and Dead River) and Connectiv (Petron).

Tom Kloza

Mobil Gives Second Quarter Gasoline Rebate

Mobil Oil is giving Middle Atlantic and Northeastern dealers a gasoline rebate for the months of April, May, and June. The rebate gives dealers the choice of same month 1997 volume or 110 percent of the same month 1996 volume, whichever is lower.

At 97 percent of total gasoline sales and 100 percent of premium sales dealers get back 3cts gal on all grades of gasoline, regardless of how many gallons are purchased. The midgrade and premium payout is contingent upon the dealer reaching 100% of base sales of the premium products.

At 103 percent of total gasoline and 105 percent of premium products, the rebate expands to 4cts gal. The 4cts on regular is paid out regardless of how many gallons are purchased, as long as the customer hits 103%. The 4cts on premium is paid only if the account hits 105 percent of premium product sales. Those in the 100 to 104.9 percent range would get a 3cts rebate on the premium grades.

The final stage of the rebate kicks in at 108 percent of total gas and 110 percent of premium products. The deal goes to 5cts gal on all grades, as long as these two thresholds are met. For purposes of the rebate, Mobil combines Special and Super Unleaded volumes.

Ben Brockwell

Colonial: Complex Model Problem Resolved

Colonial Pipeline confirms that complex model RFG shipments are now meeting new volatile organic compound (VOC) standards set by the pipeline on March 29. A pipeline spokesman tells OPIS "we have not turned down any recent shipments."

The pipeline upped the previous 13.1% standard to 17.1% after realizing that the lower standard was not getting enough VOC reductions.

Shippers had up to 300,000 bbls of complex model RFG rejected prior to the March 29 VOC change, including 125,000 bbls of Mobil's 93 octane gasoline. Citing a discrepancy between Colonial's and Mobil's testing results, Mobil spokeswoman Jeanne Mitchell said the product, shipped on Colonial March 29, had to be reclassified.

Exxon was also said to have some complex model fuel rejected but denied there was a problem. According to unconfirmed reports, the problem was with another grade of gasoline.

Valero said it was "not hurt adversely" in terms of shipments not meeting spec. "We had to change a couple of blends," said a company spokesman.

EPA will allow a 2% VOC test tolerance for the remainder of the year (this is how EPA refers to it in their letter) but aims to discontinue downstream enforcement tolerances altogether next year. In a March 26 letter to NPRA, EPA says tolerances should not be extended for motor fuels - none have been announced for standards in other areas of environmental regulation, such as water toxins.

EPA policy dictates that that enforcement discretion

Los Angeles Spot Pipeline Daily Diary

	FRIDAY (04/03)	MONDAY (04/06)	TUESDAY (04/07)	WEDNESDAY (04/08)	THURSDAY (04/09)	WK AVG.
No.2#	47.00-48.00	46.00-47.00	46.50-47.50	46.00-47.00	46.00-46.50	46.750
Carb	54.50-55.00	53.00-54.00	53.00-54.00	53.00-54.00	52.00-53.00	53.550
UnlCARFG2	58.00-59.00	56.50-58.00	57.00-57.50	56.50-57.50	55.50-56.00	57.150
PreCARFG2	64.00-65.00	62.50-64.00	63.00-63.50	62.50-63.50	61.50-62.00	63.150
Unl.	53.50-54.00	52.00-53.50	52.00-52.50	52.00-53.00	51.00-51.50	52.500
Pre.	60.00-60.50	58.00-59.50	58.00-58.50	58.00-59.00	57.00-57.50	58.600
Jet 54	49.00-50.00	47.50-48.50	46.50-47.50	46.50-47.00	46.00-47.00	47.550
RFG Unl.	57.25-58.00	55.50-57.00	56.00-56.50	55.50-56.50	54.50-55.00	56.175
RFG Pre.	63.25-64.00	61.50-63.00	62.00-62.50	61.50-62.50	60.50-61.00	62.175

San Francisco Spot Pipeline Daily Diary

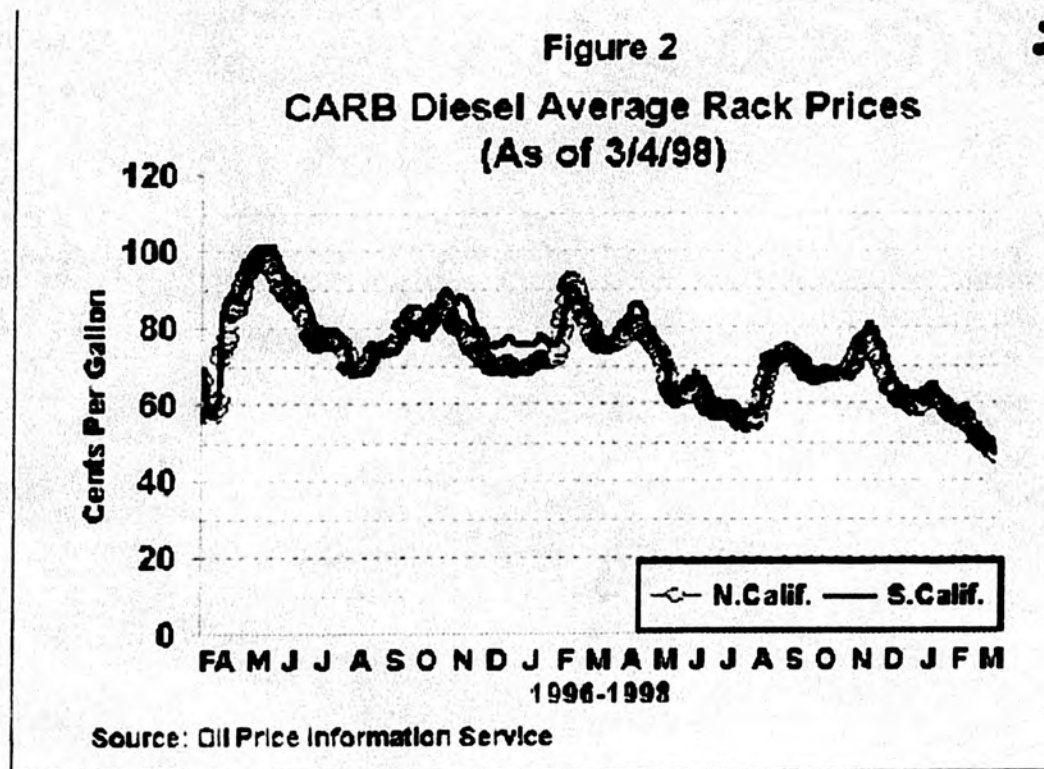
	(04/03)	(04/06)	(04/07)	(04/08)	(04/09)	
No.2#	47.50-48.50	46.50-47.50	46.50-47.50	46.00-47.00	46.00-46.50	46.950
Carb	55.00-55.50	53.50-54.50	53.00-54.00	53.00-54.00	52.00-53.00	53.750
UnlCARFG	58.00-59.00	56.00-58.00	56.50-57.50	56.25-57.25	55.50-56.50	57.050
PreCARFG	64.00-65.00	62.00-64.00	62.50-63.50	62.25-63.25	61.50-62.50	63.050
UnlCARFG2	58.00-59.00	56.00-58.00	56.50-57.50	56.25-57.25	55.50-56.50	57.050
PreCARF2	64.00-65.00	62.00-64.00	62.50-63.50	62.25-63.25	61.50-62.50	63.050
Unl.	53.50-54.00	51.50-53.50	51.50-52.50	51.75-52.75	51.00-52.00	52.400
Pre.	60.00-60.50	57.50-59.50	57.50-58.50	57.75-58.75	57.00-58.00	58.500
Jet 54	46.00-46.50	45.50-46.00	43.50-44.50	43.50-44.00	43.00-43.50	44.600

Pacific Northwest Spot Daily Diary

	(04/03)	(04/06)	(04/07)	(04/08)	(04/09)	
No.2	41.50-42.50	40.50-41.50	41.00-42.00	41.00-42.00	40.50-41.50	41.400
No.2#	48.00-49.00	47.00-48.00	48.00-49.00	47.50-48.50	47.00-48.00	48.000
Unl.	50.50-51.50	50.50-51.50	50.50-51.50	50.50-51.00	51.50-52.00	51.100
Pre.	56.00-57.00	56.00-57.00	56.50-57.50	56.50-57.00	57.50-58.00	56.900
Jet 54	48.50-49.50	47.00-48.00	47.00-48.00	48.00-49.00	47.50-48.50	48.100

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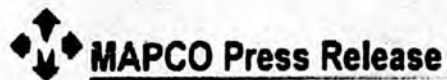
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NC = Northern California Average
SC = Southern California Average

Source: United Communications Group's Oil Price Information Service -- Phone: 1-800-929-4824, ext. 645
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March 31, 1998

Merger Closes News Release

Williams announced today it has completed the acquisition of MAPCO Inc., a strategic milestone in enhancing Williams' ability to compete for a greater share of the U.S. energy market and shifting the bulk of the company's assets into an unregulated business environment.

The acquisition is valued at \$3.1 billion based on a fixed exchange ratio of 1.665 shares of Williams stock for each share of MAPCO stock and the \$31.3125 per share price of Williams' common stock at Friday's close of trading.

The completion of the acquisition follows the Federal Trade Commission's announcement on Friday that the combination of the companies may proceed.

"Finally, we can begin delivering on the promise of the merger," said Keith E. Bailey, chairman, president and chief executive officer of Williams. "We believe even more today in the fit between the two businesses and would expect to begin quickly implementing the enhanced opportunities the combination brings. MAPCO operations should immediately add to our ongoing earnings and open new business opportunities throughout Williams."

MAPCO shareholders can expect to receive information about surrendering MAPCO stock certificates for Williams certificates shortly after the closing.

Much of the organizational structure for the combined Williams-MAPCO organization is complete. MAPCO businesses will fall under the direction of Stephen L. Cropper, president and chief executive officer of Williams' energy services group. Williams is evaluating the optimum use of its and MAPCO's headquarters buildings in Tulsa. Williams and MAPCO customers should continue to use their existing contacts unless specifically advised of a change.

The new energy services organization, which will have \$6.2 billion in assets, will include:

- An energy marketing and trading unit that is a top-tier physical and financial trading company. Its market scope is throughout North America, providing natural gas, power and petroleum products marketing at the wholesale and retail level, as well as energy financing. The unit includes MAPCO's Thermogas retail and wholesale propane business, as well as supply, marketing and trading functions from all MAPCO businesses. Jerry Gollnick, senior vice president and general manager of Williams' energy marketing & trading unit, will lead this unit.
- An exploration and production unit that operates 448 wells and has natural gas reserves of 600 billion cubic feet. It owns 1,220 square miles of 3D seismic data and is actively engaged in exploring on- and off-shore in Texas and Louisiana and in the northern and

southern Rocky Mountains. Ralph Hill, senior vice president and general manager of exploration & production for Williams, will lead this unit.

- A midstream gas and liquids unit that provides a full range of natural gas liquids marketing services through an infrastructure of gathering, processing, underground storage and distribution systems, including MAPCO's 10,000-mile Mid-America Pipeline, plus Williams' 11,000 miles of gathering lines, 10 processing plants and eight treating plants. Steve Malcolm, senior vice president and general manager of Williams' field services unit, will lead this segment.

- A petroleum services unit that includes a 9,300-mile pipeline system and 53 product terminals that move an average of 225 million barrels, or nearly 9.5 billion gallons, a year with access to 35 percent of U.S. refining capacity. Also included are MAPCO's MidSouth and Alaska refineries, MAPCO Express retail gasoline and convenience outlets, and FleetOne, MAPCO's fleet fueling and management business. This unit also can produce fuel and industrial ethanol at plants in Pekin, Ill., and Aurora, Neb. **Robert Sachse**, who served as MAPCO executive vice president and chief operating officer, will lead this unit during the transition period until the leader is named.

Williams, through its subsidiaries, is the nation's largest-volume transporter of natural gas and provides a full range of traditional and leading-edge energy and communications services. Its gas pipeline group has \$7.7 billion in assets and the communications group has \$1.3 billion in assets.

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Dynamic pricing in retail gasoline markets

Severin Borenstein*

and

Andrea Shepard**

Supergame models of tacit collusion show that supportable price-cost margins increase with expected future collusive profits, ceteris paribus. As a result, collusive margins will be larger when demand is expected to increase or marginal costs are expected to decline. Using panel data on sales volume and gasoline prices in 43 cities over 72 months, we find behavior consistent with tacit collusion in retail gasoline markets. Controlling for current demand and cost, current margins increase with expected next-month demand and decrease with expected next-month cost. The results are not consistent with intertemporal linkages due to inventory behavior or customer loyalty.

1. Introduction

In recent years, economists have developed numerous models to distinguish empirically between collusive and noncollusive pricing behaviors.¹ Generally, these studies have attempted to uncover collusive behavior by estimating relationships among contemporaneous observations of output, cost, and price. In contrast to most of these studies, we present a test for collusion that is based on the relationship between current price and expected future demand and cost conditions. Most prior studies have tested for collusion in industries best characterized as tight oligopolies: the U.S. automobile industry and 19th-century U.S. railroads, for example. We examine behavior in markets with many, differentiated firms.²

Our approach exploits the insights from supergame models in which tacitly collusive outcomes are supported by repeated play. In these models, self-enforcing collusion depends on the current gain from defecting being smaller than the anticipated

* University of California, Berkeley, University of California, Davis, and NBER; sjborenstein@ucdavis.edu.

** Stanford University and NBER; fshepard@lira.stanford.edu.

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¹ These include Porter (1983, 1985), Bresnahan (1987), Porter and Zona (1993), and Ellison (1994). Bresnahan (1989) provides a useful review.

² Throughout this article we use "collusion" to mean implicit collusion supported by repeated interaction. Successful collusion of this type does not imply that firms in these markets are earning excess profits or engaging in activities that violate U.S. antitrust laws.

future loss from the punishment triggered by defection. The gain from defecting occurs at the time of the defection and increases in current collusive profits. The punishment loss is realized in the future when other firms respond to the defection. The expected punishment loss increases in the expected difference between the future collusive profits that would have been earned absent defection and the future profit earned when firms are punishing defection. Collusion is more difficult to sustain (i.e., the highest sustainable collusive margin will be lower) when either the gain from defection is greater or the anticipated loss from punishment is lower. Using this general framework, Rotemberg and Saloner (1986) construct a model in which firms anticipate changes in demand. They show that when current demand is higher (lower) than expected future demand, collusion is more (less) difficult to sustain because the gain from cheating increases in current demand while the loss from punishment increases in future demand. Using an analogous argument, collusion is more (less) difficult to sustain when current costs are lower (higher) than expected future costs. Haltiwanger and Harrington (1991) apply this logic to a deterministic demand cycle and show that, holding constant the current level of demand and cost, collusion is more difficult to sustain when demand is declining or cost is increasing.

These models predict that current margins will respond to expected future demand or cost when firms are pricing collusively. In particular, the models predict that current margins will respond positively to expected future demand and negatively to expected future cost. These predictions are inconsistent with standard noncooperative models in which current margins are not a function of expected future conditions. Noncollusive models that could explain a link between today's margins and expected future market conditions usually rely on either consumer loyalty or inventory behavior. We argue below that these alternatives have empirical implications that are not supported by the data.

We test for collusive pricing in retail gasoline markets by examining retail margins (price at the pump minus the wholesale price). In some respects, these markets are a natural setting for the test. The theoretical models rely on predictable changes in demand and marginal cost, and there are predictable changes both in the retail demand for gasoline and in wholesale gasoline prices, which is our proxy for marginal cost.³ Because there is a marked seasonal cycle in the demand for gasoline, some of the movement in demand can be anticipated. Because there are lags in the response of wholesale gasoline prices to crude oil shocks, some of the variation in wholesale prices is also predictable.

The structure of these markets, however, is not typical of those in which collusion is commonly viewed as probable. Collusive behavior in these markets implies at least tacit cooperation over prices at gasoline stations. In the urban areas we study, there are many more gasoline stations than the "few" firms assumed in the theoretical models.⁴ Since collusion is more difficult to sustain as the number of firms increases, the existence of many firms seems incompatible with cooperative pricing. However, gasoline stations sell a product that is differentiated by brand, service, and, most importantly, location. The number of firms operating in a metropolitan area, therefore, may not be a good indicator of the number of effective competitors in any actual retail market. Further, prices at stations need not be set independently: some stations have a common manager who sets prices at all stations he/she owns or manages. In addition, retail prices are posted and can be changed quickly and at low cost, making it easy to detect

³ Wholesale gasoline price constitutes about 85% of the retail price. The other significant contributors to the marginal retail cost are (some) labor costs and the costs of delivering gasoline from the terminal to the retail outlet. Neither of these other components are nearly as volatile as the wholesale price.

⁴ See Borenstein and Gilbert (1993) for information on retail market structures.

from defecting occurs. The punishment is severe. The expected future collusive profits are greater when firms defect. In the Rotemberg framework, Rotemberg (1987) shows that changes in demand, expected future demand, and the probability of being caught increase the incentive to defect. Using an infinite horizon model, Rotemberg (1991) applies the Rotemberg model to the current market when demand is de-

fecting future demand. He predicts that current margins are negatively affected by expected future demand. Noncollusive behavior is predicted by the data.

Rotemberg (1991) argues that retail margins in these markets are affected by changes in demand in the retail market. For marginal cost, gasoline, some of the changes in the response of margins in wholesale prices

are in which collusion is implied at least in the data. In the Rotemberg model, as demand increases, the existing margins increase. However, gasoline margins, most importantly, are not. Therefore, the Rotemberg model may not be a good approximation of the actual retail market. Rotemberg (1991) shows that margins have a common response. In addition, retail margins are easy to detect

defection and respond rapidly. As a result, the gain from defecting will be small, making tacit collusion easier to sustain.

Further, prior research indicates that pricing in retail gasoline markets is not well characterized by standard competitive models. Slade (1986) presents evidence from a single retail market in Vancouver that station-level demand is not perfectly elastic and rejects the hypothesis of competitive pricing. In related work, Slade (1987) concludes that pricing in the Vancouver market is characterized by implicit collusion in which periods of cooperation alternate with price wars triggered by demand shocks. Borenstein (1991) and Shepard (1991) show that U.S. gasoline stations have sufficient local market power to implement price discrimination across gasoline grades or service levels. Although the structure of the market makes it unlikely that the firms come close to achieving the monopoly price in a supgame equilibrium, these results suggest that the possibility of some collusive pricing cannot be rejected *a priori*.

Our work is most closely related to Ellison's (1994) test of the Rotemberg and Saloner model using data on railroad prices and outputs during the era of the Joint Executive Committee cartel. Ellison models the collusive price as a function of the ratio of current to expected future demand. He finds no evidence of an effect on current margins, but notes that the explicit railroad cartel might not be an environment in which the implicit collusion of the Rotemberg-Saloner model is likely to apply. Hajivassiliou (1989) also tests this model in the Joint Executive Committee cartel, but relies on contemporaneous price and quantity data only. He finds little support for the prediction that collusion is less likely when current demand is high.

The results of our analysis are consistent with the predictions of the collusive pricing models. Controlling for current demand and wholesale price, we find that current margins increase with expected next-period demand and decline with expected next-period wholesale price. The magnitudes of these effects are not large in absolute value: increasing expected next-period demand by 10% increases the current margin, which averages about eleven cents, by about .42 cents. Increasing the expected wholesale price of gasoline by ten cents reduces current margins by about .63 cents. The economic importance of these effects is not in the magnitude of their impact on consumer prices, but in what they suggest for the behavior of firms in these markets. They indicate that departure from single-period Nash behavior may be more common than is suggested by studies focusing on tight oligopolies. They also demonstrate that the technique used here to uncover firm behavior might be useful in markets where collusion would have more pronounced welfare effects.

In the following section we describe the models on which the empirical work is based. In Section 3 we discuss the data we use and in Section 4 the estimation procedure. The results are presented in Section 5. We discuss alternative hypotheses in Section 6 and offer concluding comments in Section 7.

2. Models of price dynamics

Bresnahan (1989) and others point out that diagnosing collusive pricing from only contemporaneous price, cost, and demand data is quite difficult. The fact that noncooperative behavior is consistent with a variety of pricing patterns poses a serious problem in these endeavors. For example, noncooperative prices may increase or decrease in response to positive demand shocks, depending on the cost structure and whether the shocks change the composition of demand as well as its level.¹ As a result, efforts to distinguish collusive from noncooperative behavior generally have relied upon restrictive assumptions about the functional forms of demand and cost. Recent models

¹ For this reason, we do not focus on the effect of current demand to diagnose implicit collusion.

of collusion, however, have implications for dynamic pricing that more easily distinguish the behavior consistent with these specific models from noncooperative outcomes.

Rotemberg and Saloner (1986) develop a model in which firms sustain implicit collusion by adjusting current margins in response to anticipated changes in demand. In their model, very-high-demand periods are outlying realizations of an independently and identically distributed demand shock. An individual firm has a relatively large incentive to deviate from the collusive price in these periods because it is able to capture a share of an unusually large market by doing so. Current deviations would be punished by lower prices in future periods. If deviation is to be prevented, the potential loss earned by the firm in the punishment phase must be at least as great as the potential gain from deviating in the current period. The punishment loss anticipated by a deviating firm is the present value of the difference between the profits it expects to earn in the future while colluding and those it expects to earn under the lower, punishment prices. If demand is independently and identically distributed, current demand realizations have no effect on expectations of future demand, and the expected loss is constant. In high-demand periods, then, collusion can be sustained only by reducing the gains to deviating, i.e., by reducing current collusive profits. The highest sustainable collusive margin will therefore be lower in periods after which demand is expected to decline.

Haltiwanger and Harrington (1991) reformulate this model in the context of a deterministic demand cycle. In this environment, it is possible to distinguish the level of demand from the expected change in demand.⁶ To understand their model, it is easier to reverse the thought experiment and hold constant the gain from deviating. Consider a simple model in which firms have constant marginal cost, produce an undifferentiated product, and engage in Bertrand competition during punishment periods. Assume that monopoly (or perfectly collusive) profits would be procyclical (i.e., increase with demand). Notice that the Bertrand assumption and constant marginal costs imply that punishment-period profits are always zero.

Consider two periods, t_1 and t_2 , with equal demand. Because current demand is equal, the gain from deviating is equal. Suppose that demand is increasing at t_1 and declining at t_2 . Near-term, future collusive profits are, therefore, expected to be higher at time t_1 than at t_2 . Because near-term profit is weighted more heavily in evaluating the present value of future profits, the expected collusive profit forgone by deviating is higher at t_1 . With punishment profit constant by assumption, this means that the loss from deviating will be higher at t_1 . The highest sustainable collusive margin will therefore be higher at t_1 than at t_2 . In this formulation, margins respond positively to changes in expected near-term demand, holding constant current demand.

Both the Rotemberg-Saloner and Haltiwanger-Harrington models explicitly hold marginal cost constant over time. If changes in input prices create predictable shifts in marginal cost, however, it is straightforward to show that these models also imply that margins will be affected by expectations about future marginal cost. Suppose demand does not change over time and marginal cost is invariant to output. Then if input prices are expected to rise next period, the expected increase in marginal cost will cause expected collusive profits to decline. This will reduce the potential loss from future punishment. Therefore, holding constant current marginal cost, expected future changes in marginal cost will have a negative effect on current margins.

This discussion suggests three tests for collusive pricing. First, collusive margins will respond to anticipated changes in cost and demand. Second, controlling for current

⁶ In the Rotemberg-Saloner model, the distinction between level and derivative cannot be made. A high demand necessarily implies a negative expected derivative, and a low demand implies a positive expected derivative.

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demand, margins will respond positively to expected increases in near-term demand. Finally, controlling for current input prices, margins will respond negatively to expected increases in the input prices.

Before proceeding to the empirical test of these predictions, it is important to recognize that these stylized game-theoretic models do not precisely comport with conditions in retail gasoline markets. For our application, the most troublesome assumption of these models is that punishment profits are invariant to demand and cost movements. If punishment means a reversion to a noncooperative equilibrium so that "punishment" and "noncollusive" profits are equal, this assumption might be violated in gasoline markets. On the demand side, there is reason to believe that noncollusive margins would be changed with demand.⁷ In this case, the preceding argument about the relationship between expected demand changes and collusive margins relies on the effect of demand changes on collusive profits being larger than the effect of demand changes on noncollusive profits. Similarly, the prediction that margins will respond negatively to expected future input price changes assumes that a change in cost will change collusive profits more than noncollusive profits. While that is the case in many models, it is not general.

What this implies for our empirical work is that the signs of the effects of future demand and input costs on current margins are not unambiguous, as they are in the stylized models. Margins should still respond to expected future cost and demand conditions when firms are colluding. So a finding of any effect of expected future conditions on current margins supports the claim that firms are not in a noncooperative equilibrium. However, we are not certain that the effects will run in the direction predicted by the models.

3. The data

■ The estimation procedure uses data on retail prices, wholesale prices, crude oil prices, and gasoline demand. We describe these data in this section, along with some relevant details on gasoline distribution. Descriptive statistics appear in Table 1.

Retail margin is defined as the retail price (the price paid by consumers at the pump) minus the wholesale price of gasoline. The price at the pump is clearly defined, but selecting the appropriate "wholesale" gasoline price is complicated by the structure of gasoline production and distribution and by observability. Retail gasoline markets are local: consumers typically buy gasoline within a limited geographic area. The relevant price for a given retail market, then, is the wholesale price of gasoline in that geographic area. Wholesale gasoline markets are defined by terminal locations. Most larger cities (and all those in our sample) have a city terminal supplied with gasoline by pipeline or water transport. From the terminal, gasoline is trucked to gasoline stations by refiners or by independent distributors who purchase gasoline at the terminal. Any given station has a single wholesale supplier.

Approximately 55% of the retail gasoline sold in the United States is sold at stations supplied by independent wholesales (called "jobbers" in the gasoline industry; see Temple, Barker, and Sloan, Inc. (1988)). At the terminal, jobbers are charged a posted price set by refiners on a terminal-by-terminal basis. This is called the "terminal price." Jobbers own and operate some of the stations they supply, and for gasoline sold at these stations there is no additional wholesale market transaction. At stations that jobbers supply but do not operate, there is a transaction between the jobber and

⁷ One argument is that high-demand periods have disproportionately more demand from vacation travelers who are buying gasoline in unfamiliar locations and therefore have higher search costs. Higher search costs imply that firm-level elasticities will be higher. For a more complete discussion, see Borenstein and Shepard (1994).

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Table 1 Descriptive Statistics (2,873 observations)

Variable	Mean	Standard Deviation	Minimum	Maximum
Retail price (cents per gallon) <i>RETAIL</i>	72.81	12.56	43.18	126.57
Terminal price (cents per gallon) <i>TERMINAL</i>	61.82	11.94	36.00	111.88
Crude oil price (cents per gallon) <i>CRUDE</i>	46.02	10.90	25.83	87.98
Retail-terminal margin (cents per gallon) <i>MARGIN</i>	10.99	5.41	-8.91	34.90
Gasoline volume (gallons $\times 10^6$ /day) <i>VOLUME</i>	6.56	6.54	.38	38.11
Normalized gasoline volume <i>NVOLUME</i>	1.004	.093	.570	1.617
Expected normalized gasoline volume <i>EXP NVOLUME</i>	1.004	.086	.633	1.402
Expected terminal price (cents per gallon) <i>EXP TERMINAL</i>	62.05	11.09	36.45	112.77

station operator, but the price for this transaction is not publicly available. Similarly, for the gasoline sold at stations supplied directly by a refiner, there is no additional wholesale transaction if the station is owned and operated by the refiner. At the independently operated stations they supply, refiners sell gasoline to the station at the "dealer tankwagon price" (DTW). The DTW price is posted at the terminal. Less than 30% of the gasoline sold in the United States is sold at these refiner-supplied, but independently operated, stations (see U.S. Department of Energy (1988)).

For our purposes, the terminal price is the best proxy for marginal cost. For jobbers, it is the only observable wholesale price. It is also the opportunity cost of gasoline sold through refiner-supplied stations. Finally, unlike the DTW price, the terminal price is less subject to discounting off the posted price, according to people familiar with the industry. Refiners and station operators report that there is widespread discounting off posted DTW prices.⁸ Unobservable, systematic discounts would be particularly troublesome here because their depth and prevalence probably varies with the refiner's perception of profitability in a given market at a particular time.

Because we use terminal price as the input cost, the margin we use for the empirical work is potentially affected by both the supplier (jobber or refiner) and the station operator. At stations operated by the supplier, the margin is set by the supplier alone. At independent stations, the retail price is set by the station operator but may also be affected by the supplier's use of quantity forcing and nonlinear pricing in the delivered price.⁹ Without future information, it is impossible to determine whether the patterns we observe in retail margins reflect primarily the response of refiners and jobbers or of station operators.

⁸ One person employed by a major refiner to set its delivered prices reported that a substantial portion of his division's effort was expended trying to infer rivals' actual delivered prices from their posted DTW prices.

⁹ For a more complete discussion of how retail prices are set, see Shepard (1993) and Borenstein and Gilbert (1993).

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City	Maximum
8	126.57
0	111.88
3	87.98
1	34.90
3	38.11
0	1.617
1	1.402
5	112.77

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For retail prices (*RETAIL*) we use the average price for unleaded, 87 octane, self-service gasoline in each of 43 cities. These averages are reported by Lundberg Survey based on a monthly survey of gasoline stations in each city.¹⁰ Lundberg reports the survey date and the average price in the city for that date. The surveys always occur on a Friday, and the stations sampled change infrequently. The prices have been adjusted to exclude all sales and excise taxes. As is the case for all prices used in the study, retail prices are in nominal dollars.¹¹

The terminal price (*TERMINAL*) is the average of all branded, unleaded, 87 octane terminal prices posted at the city terminal as reported by Lundberg. Because Lundberg reports average terminal prices for each Friday, we can match the average terminal and retail prices by date and city. The retail margin (*MARGIN*) is simply *RETAIL* - *TERMINAL* for a given city at a point in time.

Figure 1 shows the monthly movement in retail, terminal, and crude oil prices for 1986-1991.¹² As is clear in the graph, a large share of the volatility in terminal prices (and therefore in retail prices) is the result of shocks to the price of crude oil. The effect of the Gulf War in 1990-1991, for example, is quite clear in the data, as is the waning effect of the OPEC cartel at the beginning of the sample period. Although this is less clear in the figure, terminal prices respond with a lag to shocks to crude oil. Borenstein and Shepard (1996) estimate that approximately two-thirds of the eventual passthrough of crude price changes occurs in the first two weeks following the shock. The lags imply that future terminal prices will be influenced by both current and past crude price movements. As a result, decisionmakers have information from which to form time-varying expectations about future terminal prices. In the econometric model, we exploit this relationship to estimate expected terminal prices.

The data on gasoline consumption (U.S. Federal Highway Administration) are the total retail volume of gasoline sold in each state in each month. These data are tied to payment of the federal excise tax on gasoline. For each city, we use the volume data for the state in which the city is located. In those states for which Lundberg provides data on more than one city, we have randomly selected a single city to avoid replicating the volume data.¹³ We divide the monthly volume figures by the number of days in the month to get an average daily consumption series for each state.

Movements in the quantity of gasoline consumed per day, as shown in Figure 2, are much more regular than the movements in price.¹⁴ Gasoline demand follows a clear seasonal pattern in the United States: national demand is higher in the summer months, with the annual peak in August and the trough in January. On average, the August peak consumption is 23% above the January trough. There is also long-run movement in consumption—annual volumes rise over the first half of the 1986-1991 period and then decline again—but this is swamped by the seasonal movement.

Because the volume data are cumulative monthly consumption, we have only average daily consumption for each month. The price data, in contrast, record the average price on a single Friday in the month. This raises the issue of how best to match the

¹⁰ This seems to be the best data series on retail prices. Other sources, such as *Oil and Gas Journal*, estimate retail prices from wholesale prices.

¹¹ During our sample period, inflation was fairly stable at about 4%. The results are virtually unchanged if we deflate all prices by the consumer price index.

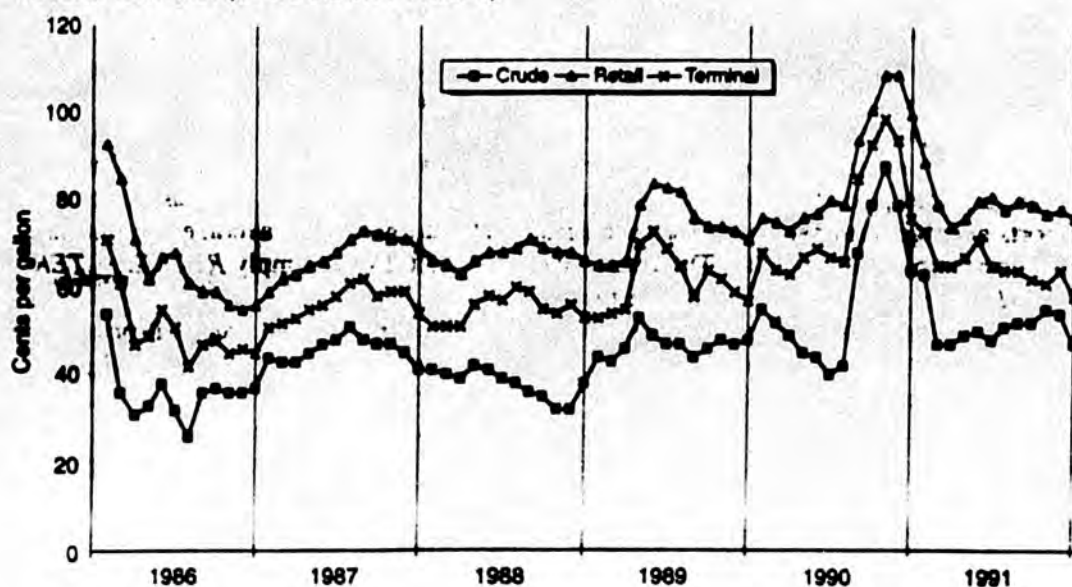
¹² The retail and terminal price series in Figure 1 are average monthly prices for the 43 cities included in our sample. The crude oil price series is the gulf coast spot price for West Texas Intermediate crude oil. The sample period is determined by the available retail gasoline price and volume data. We have gasoline price data for 1986-1992 and volume data for 1982-1991.

¹³ We also estimated the empirical model using data on all (59) cities for which data are available. The results were substantively the same as those reported in Tables 2 and 3.

¹⁴ The data for Figure 2 are average daily consumption for the 43 cities in our sample. They are not the interpolated series described below, but interpolation would have no substantive effect on the figure.

FIGURE 1

PRICES 1986-1991 (AVERAGE CITY PRICES)



price on a given Friday with the average daily volume series. The daily volume for the first Friday in April, for example, is probably best approximated by some combination of the average daily volume in March and in April. We therefore use a linear interpolation approach to construct a weighted average of the daily volumes in adjacent months.¹⁵ The weighting scheme assigns a weight of one to the j th month's average daily volume if the observation happened to record prices on the middle day of that month. The weight on the current month declines linearly with movement away from the middle day. If, for example, prices were recorded for the first day of the month, the weighting scheme would apply a weight of about one-half to the average daily volumes of months j and $j - 1$.¹⁶ The interpolated daily average is reported in Table 1 as *VOLUME*.

Finally, we divide the interpolated daily average in each state by its state mean over the sample period. The resulting normalized volume series (*NVOLUME*) expresses consumption as a proportion of the state's average daily consumption. This normalization removes the cross-sectional variation in daily volume introduced by variations in state populations: over 99% of the variance in *VOLUME* is accounted for by differences between state means. States with higher means also have more variation around the mean in absolute magnitude. If the effect of volume on margin were estimated using absolute deviations from state means in a standard fixed-effects formulation, the estimates would be heavily influenced by differences in state populations. *NVOLUME* removes this variation, leaving us with a series in which the remaining cross-sectional

¹⁵ In unreported estimates, we used a cubic rather than a linear spline. We have also used the reported-month daily volume with no interpolation. The results are robust to the interpolation technique.

¹⁶ More precisely, if v_j is the average daily volume for month j , which has n_j days, and d_y is the day on which retail price is observed, then the interpolated volume on the day price is observed, v_y , is given by

$$v_y = \begin{cases} v_j \left(\frac{1}{2} + \frac{d_y}{n_j} \right) + v_{j-1} \left(\frac{1}{2} - \frac{d_y}{n_j} \right) & \text{if } d_y \leq \frac{n_j}{2}; \\ v_j \left(\frac{3}{2} - \frac{d_y}{n_j} \right) + v_{j-1} \left(\frac{d_y}{n_j} + \frac{1}{2} \right) & \text{if } d_y \geq \frac{n_j}{2}. \end{cases}$$

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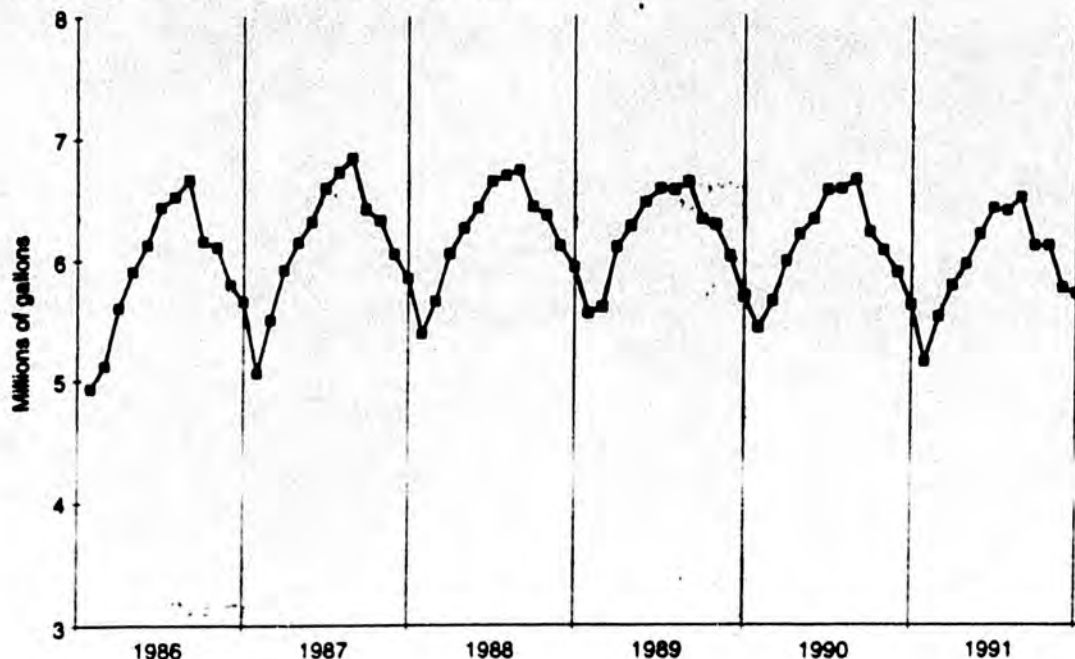
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FIGURE 2

DAILY VOLUME 1986-1991 (STATE AVERAGES)



variation reflects temporal differences in state-level demand patterns. Using *NVOLUME* also provides us with a better variable for station-level demand. A 20% change in California daily volume represents (approximately) a 20% change at the observed California stations. This change is comparable to the change at Vermont stations that is represented by a 20% change in Vermont demand.

4. Estimation Issues

■ A number of estimation issues must be addressed to develop consistent estimates of the effect of expected future demand and cost on current margins. As we argue below, the correct procedure involves estimating expected future demand and cost, allowing for lagged responses of both retail and wholesale prices to crude oil shocks, correcting for heteroskedastic and correlated errors, and instrumenting for endogenous variables. Before addressing all of these issues, however, we take a simple "first cut" at the data to explore the basic relationships. These preliminary estimates (reported in Table 2) should be viewed only as descriptive statistics and as a motivation for the empirical models developed later.

□ **Data exploration.** We begin by running an ordinary least squares regression of margin on current volume, next-period volume, current terminal price, next-period terminal price, and a set of time and city fixed effects. Next-period volume (*NVOLUME_{t+1}*) and terminal price (*TERMINAL_{t+1}*) are included as proxies for the expected future values that the theory predicts will influence current margins. There are two concerns about these proxies. First, it is expected values, not actual values, that should affect current margin decisions. We address this problem in subsequent estimations.

Second, we have chosen to represent the future by only the next period, a simplification retained throughout our analysis. In the theory, the number of empirically relevant future periods depends on the length of the punishment period and the discount

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used the reported- que. and d_{jt} is the day j , ψ_{jt} is given by

Table 2 Preliminary Regressions
Dependent Variable: *MARGIN*,

	OLS	OLS-ARI	OLS	OLS-ARI
<i>NVOLUME_i</i>	3.777 (1.545)	1.426 (1.031)	3.685 (1.440)	1.277 (1.016)
<i>NVOLUME_{i-1}</i>	1.645 (1.597)	1.844 (1.291)	2.826 (1.436)	2.301 (1.196)
<i>TERMINAL_i</i>	-.262 (.021)	-.431 (.020)	-.093 (.022)	-.134 (.025)
<i>TERMINAL_{i-1}</i>	-.028 (.021)	-.066 (.018)	-.023 (.020)	-.047 (.017)
Δ <i>TERMINAL_i</i>			-.323 (.021)	-.284 (.018)
ρ		.520 (.016)		.558 (.015)
Observations	2,873	2,873	2,873	2,873
R^2	.652	.636	.686	.684

Notes: Fixed time and city effects not reported. White's heteroskedastic-consistent standard errors in parentheses.

rate. The theoretical models of tacit collusion leave open the length of the punishment period. Both the Rotemberg-Saloner and Haltiwanger-Harrington models use infinite punishments to simplify exposition, but their results do not depend on infinite punishments. If punishments are infinite, all future periods are relevant, and discounting makes the near-term periods relatively more important than later periods. If punishments are of finite duration, the relative importance of near-term periods will be greater. In the absence of any information about how long the punishment period might be in these markets, we include only next-period values. If the punishment is longer than one month, we will be measuring the relevant variable with error, and our estimate of the magnitude of the effect is likely to be biased downward.

Because the volume series display correlation over time, we include current volume (*NVOLUME_i*) among the regressors in this simple regression. Omitting current volume would load the effect of both current and future volume on the coefficient on next period's volume. Current terminal price is included to allow margin to respond to the level of the primary input price.¹⁷ We also include a set of 72 monthly and 43 city fixed effects. As is clear from the plot in Figure 1, there are periods in which the price series display unusually large movements. Removing the mean effect for each of the months in the sample ensures that the results are not driven by these events. Approximately 30% of the variance in margin is accounted for by these time fixed effects. An additional 31% of the variance is explained by city fixed effects. All the regressions reported here remove time and city fixed effects.¹⁸

¹⁷ Current terminal price is already in the dependent variable. We include it on the right-hand side to allow an unrestricted response of margins to current terminal prices. Omitting *TERMINAL_i* from the regressors would be equivalent to imposing full (i.e., one-for-one) and immediate passthrough of terminal price changes into retail prices.

¹⁸ The regressions presented here and below rely on the retail, terminal, and crude oil price variables being cointegrated. Carrying out the cointegration test suggested by Greene (1993) yields the following *t*-statistics, each of which strongly rejects the hypothesis that the variables are not cointegrated (using the Dickey-Fuller tables): retail-terminal, -25.31; retail-crude, -19.95; terminal-crude, -22.93.

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The resulting coefficient estimates are presented in the first column of Table 2 and are roughly consistent with the predictions of the theoretical models. Conditional on contemporaneous volume and terminal price, current margins are a declining function of next period's terminal price and an increasing function of next period's volume. The estimated coefficient for the effect of next period's volume is, however, quite noisy.

The residuals from this regression display first-order autocorrelation. Given the evidence from prior studies that retail prices are affected by lagged terminal prices, this is not surprising. Correcting the estimates for an AR1 process (see column 2) does not affect the conclusion about the effect of future values on current margins. It does, however, have a large effect on the coefficient on current terminal. The magnitude of the change in this coefficient is about eight times its standard error.

The effect of the AR1 correction on the *TERMINAL*_{*t*} coefficient suggests that it would be appropriate to include lagged values of terminal prices in the regression. We take the first step in this direction by adding $\Delta \text{TERMINAL}_t = \text{TERMINAL}_t - \text{TERMINAL}_{t-1}$ to the regressors. Including this simple lag structure does not eliminate the AR1 process, but (as reported in the third and fourth columns of Table 2) the coefficient estimates are now more stable. The positive effect of next period's volume and the negative effect of next period's terminal price on current margin persist in this specification.

These descriptive regressions suggest that the estimates from a more careful procedure might uncover effects consistent with the theory of tacit collusion. We begin this effort by describing the procedure we use to construct variables for expected volume and terminal price.

□ **The empirical model.** The results from preliminary regressions suggest that the specification of the lag structure of retail price response might have important effects on the results. We therefore estimate two different models of the lag process. The simpler specification is given by¹⁹

$$\begin{aligned} \text{MARGIN}_{it} = & \alpha_1 \text{NVOLUME}_{it} + \alpha_2 \text{EXP NVOLUME}_{it-1} + \alpha_3 \text{TERMINAL}_{it} \\ & + \alpha_4 \text{EXP TERMINAL}_{it-1} + \alpha_5 \Delta \text{TERMINAL}_{it} + \epsilon_{it} \end{aligned} \quad (1)$$

where *i* indexes cities, *EXP NVOLUME*_{*it-1*} is expected next-period volume, and *EXP TERMINAL*_{*it-1*} is expected next-period terminal price.

While equation (1) is parsimonious, it does not allow for the complex lag structure in the response of gasoline prices that has been found in prior research. (See, for example, Karrenbrock (1991), Bacon (1991), U.S. General Accounting Office (1993), Borenstein, Cameron, and Gilbert (1995), and Borenstein and Shepard (1996).) These studies indicate that the response of retail prices may involve lags longer than one month and may be asymmetric with respect to terminal price increases and decreases. In addition to the lagged response to terminal price changes, retail price changes display persistence. One common effect of persistence is some form of autocorrelation in the error structure of price equations. More generally, retail price changes are a function of lagged changes in retail prices.

A standard approach to estimation in the presence of lagged responses is to model price as a vector autoregression (VAR) process in which the current change in price is a function of past shocks and an error-correction term that takes into account the underlying structure relationship. In our context, this means modelling the change in retail price, and therefore margins, as a function of contemporaneous and lagged

¹⁹ In this and the following estimation equations, we suppress the constant term, which is absorbed by city and time fixed effects.

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changes in terminal prices, lagged changes in retail prices, and an error-correction term involving the one-period lags of retail and terminal prices:

$$\begin{aligned} \text{MARGIN}_{it} = & \alpha_1 \text{NVOLUME}_{it} + \alpha_2 \text{EXP NVOLUME}_{it-1} + \alpha_3 \text{EXP TERMINAL}_{it-1} \\ & + \beta_1 \Delta \text{TERMINAL}_{it}^+ + \beta_2 \Delta \text{TERMINAL}_{it-1}^+ + \beta_3 \Delta \text{TERMINAL}_{it-2}^+ \\ & + \beta_4 \Delta \text{TERMINAL}_{it}^- + \beta_5 \Delta \text{TERMINAL}_{it-1}^- + \beta_6 \Delta \text{TERMINAL}_{it-2}^- \quad (2) \\ & + \beta_7 \Delta \text{RETAIL}_{it-1}^+ + \beta_8 \Delta \text{RETAIL}_{it-2}^+ + \beta_9 \Delta \text{RETAIL}_{it-1}^- \\ & + \beta_{10} \Delta \text{RETAIL}_{it-2}^- + \beta_{11} \text{RETAIL}_{it-1} + \beta_{12} \text{TERMINAL}_{it-1} + \epsilon_{it} \end{aligned}$$

where ΔX_{it} denotes $X_{it} - X_{it-1}$ and the $+$ superscript denotes an increase and the $-$ a decrease. The contemporaneous and lagged changes capture the transmission of shocks, while the error-correction term captures the tendency to revert gradually to the long-term equilibrium relationship between retail and terminal prices. The number of lag periods has been chosen to allow for longer-than-expected lags in response. In the spirit of imposing only a minimal structure on the data, both retail and terminal price changes have been decomposed to allow an asymmetric response to price increases and decreases.²⁰ The details of deriving this estimating equation from the standard VAR treatment of price changes are given in the Appendix.

Estimating either (1) or (2) requires constructing variables representing expected volume and terminal prices. To construct *EXP NVOLUME*, we assume that station operators and suppliers form their expectations of next-period demand based on current and past sales volumes observed in their markets. Volume changes are caused largely by seasonal shifts in consumption patterns and, to a much lesser extent, by variations in retail prices. Demand seasonality varies across geographic locations in both pattern and amplitude. Although the typical state sees its peak demand in August and lowest demand in January, August demand is below the state mean in Florida and January demand is above the state mean in Colorado and Hawaii. The state in our sample with the greatest average annual variation (Maine) has a peak-to-trough difference equal to 57% of mean volume for that state; the state with the smallest variation (Arizona) has a peak-to-trough difference equal to 7% of its mean. The average state has a peak-to-trough difference equal to 23% of its mean. To allow the data to reflect these variations, we predict volume on a state-by-state basis. Accordingly, the predicting equation for state i is

$$\begin{aligned} \text{NVOLUME}_{it} = & a_0 + a_1 \text{NVOLUME}_{it-1} + a_2 \text{RETAIL}_{it-1} \\ & + \sum_{j=2}^{12} \delta_j \text{MONTH}_j + a_3 \text{TIME}_i + a_4 \text{TIME}_i^2 + \epsilon_{it} \quad (3) \end{aligned}$$

where *MONTH_j* is a monthly dummy variable. For nearly all cities, the R^2 of these predicting equations is between .80 and .95. *EXP NVOLUME* is the fitted values from estimating (3).

Our procedure uses future data on volume to estimate the coefficients in the predicting equation (and, similarly, we use future prices in the predicting equations for prices). This is, in principle, incorrect because it uses information the decisionmakers did not have when they formed their coefficient estimates. If, however, the coefficients

²⁰ Including more lags than may be required or allowing for asymmetries unnecessarily will not bias the estimate of other coefficients.

do not characterize them. To characterize them using a rolling station prices based on prices in the lagged and use all information to the VAR.

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The crude oil as reported in *Wall Street Journal* (ΔCRUDE_{it}) is the best forecast. The R^2 of the forecasts are seasonal patterns which approach the expected.

Both equations and terminal prices are a function of expected next-period volume. *EXP NVOLUME* is also a function of markets for price to influence competitive terminal and cru-

²¹ We use sample period have chosen to use Borenstein using spot price terminal and cru-

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do not change over time, we would get similar results using only data available to them. To check for robustness to the predicting procedure, we also predicted volume using a rolling regression with volume data for 1982-1991. Neither the predicted values nor the coefficients in the final regressions were substantively affected.²¹

Station operators and suppliers form their expectations of next-period terminal prices based on observing the price of crude oil and the time structure of terminal prices in their market. Analogous to retail prices, terminal prices are a function of lagged and current crude oil prices and lagged terminal prices. Because we want to use all information available to decisionmakers, we use the full lag structure analogous to the VAR model in equation (2):

$$\begin{aligned} \text{TERMINAL}_{it} = & b_1 \Delta \text{TERMINAL}_{it-1}^* + b_2 \Delta \text{TERMINAL}_{it-2}^* + b_3 \Delta \text{TERMINAL}_{it-1}^- \\ & + b_4 \Delta \text{TERMINAL}_{it-2}^- + b_5 \Delta \text{CRUDE}_{it-1}^* + b_6 \Delta \text{CRUDE}_{it-2}^* \\ & + b_7 \Delta \text{CRUDE}_{it-1}^- + b_8 \Delta \text{CRUDE}_{it-2}^- + b_9 \text{TERMINAL}_{it-1} \\ & + b_{10} \text{CRUDE}_{it-1} + \sum_{j=1}^{12} \delta_j \text{MONTH}_j + \epsilon_{it} \end{aligned} \quad (4)$$

We estimate this equation city by city because the response of terminal prices to common crude oil shocks displays substantial variation across cities. Some of the difference in responses comes from the distribution system (Spiller and Huang, 1986) and some from differences in the conduct of competitors at the terminal (Borenstein and Shepard, 1996).

The crude oil price we use is the gulf coast spot price for West Texas Intermediate crude as reported by *Dow Jones International Petroleum Report* and published in the *Wall Street Journal*.²² In contrast to equation (2), contemporaneous change in CRUDE (ΔCRUDE_{it}) is not included in (4), because the purpose of this estimation is to generate the best forecast of TERMINAL from information available during the previous period. The R^2 of these regressions varies across cities within the .30 to .60 range. Price forecasts are less accurate than volume forecasts because volume follows a strong seasonal pattern, while terminal prices are very sensitive to current crude oil prices, which approximately follow a random walk. The fitted values from these regressions are the expected terminal prices for the period.

Both equations (1) and (2) include endogenous variables. Contemporaneous volume and terminal price are both reasonably modelled as endogenous. Volume is directly a function of the retail price and, therefore, a function of retail margin. Because expected next-period volume is a function of current volume and retail price, EXP NVOLUME is also endogenous. Terminal price will be a function of retail price if the terminal markets for gasoline are not perfectly competitive so that refiners set the wholesale price to influence the retail price. Terminal prices also will be endogenous if the market is competitive but refiners have an upward-sloping supply curve. Since EXP TERMINAL is a function of current terminal price, it is also endogenous. As a result, OLS

²¹ We use the approach represented in equation (3), because we do not have data on prices for the presample period. Without presample price data we cannot use the rolling regression approach for prices and have chosen to be consistent across predicting equations.

²² Borenstein, Cameron, and Gilbert (1995) report that using futures prices rather than spot prices or using spot prices for other commonly traded crude oils does not affect the estimated relationship between terminal and crude oil prices.

estimates of the margin equations are biased.²³ We provide consistent estimates for these equations using a two-stage least-squares (2SLS) procedure.

We identify the effects of volume and terminal price in 2SLS estimation by recognizing that these variables respond differently across cities to seasons, time, and changes in crude oil prices. As noted previously, seasonal demand patterns differ across cities depending on the weather and the tourist orientation of the area. Over time, these variables have also changed at different rates across areas. The response of terminal prices to changes in crude oil prices differs depending on transportation costs, proximity to a major port, alternative energy sources, and nongasoline uses of oil in the region. Gasoline demand and terminal prices might also be affected by changes in local economic conditions. Thus, besides the included exogenous variables, the instrument set for 2SLS estimation of (1) and (2) includes 11 separate monthly dummy variables for each city ($MONTH_{it}$, $i = 1, 43$, $j = 1, 11$), time and time-squared variables for each city ($TIME_{it}$ and $TIME_{it}^2$, $i = 1, 43$), seven variables for adjustment to current and past crude oil price changes for each city ($\Delta CRUDE_{it}$, $\Delta CRUDE_{it-1}$, $\Delta CRUDE_{it-2}$, $\Delta CRUDE_{it-3}$, $\Delta CRUDE_{it-4}$, $\Delta CRUDE_{it-5}$, and $\Delta CRUDE_{it-6}$, $i = 1, 43$), and the current and lagged unemployment rate for the state.²⁴

The endogeneity problem for equation (1) raises an additional complication because there is serial correlation in the OLS residuals. As a result, the lagged values of terminal in $\Delta TERMINAL_{it}$ are endogenous and the standard AR1 correction procedure is invalid. To correct for the additional endogenous variables, we treat the lagged values as endogenous, add an additional lag to the $CRUDE$ variables in the instrument set and implement an AR1 correction following Greene (1993). Durbin's test for autocorrelation in the presence of lagged dependent variables (Greene, 1993) indicates no serial correlation in equation (2).²⁵

Although we use an appropriate procedure to produce consistent estimates in the presence of endogeneity, we expect that the bias in the OLS estimates would be quite small. The estimated equations are supply relations, and the primary source of bias (directly for volume variables and indirectly for terminal price variables) is from movements along the demand curve rather than shifts of the demand curve. Industry demand for gasoline, however, is quite inelastic in the short run, with estimates ranging from $-.08$ to $-.2$ (Dahl and Sterner, 1991). It is clear, then, that the exogenous shifts in demand account for a much greater variation in consumption than is attributable to price changes. In fact, the 2SLS estimates do not differ substantially from the OLS estimates, as we show below.

Finally, the errors for both equations are heteroskedastic. We expected that the variance of the residuals would be a function of both the average retail margin in a city and the volatility of crude oil prices.²⁶ This suspicion was confirmed by regressing the square of the residuals on the average margin for each city and the sum of the absolute value of the change in crude oil price over the last three months: both variables

²³ In each specification, endogeneity tests reject the exogeneity of some of the current or expected volume and terminal prices and reject the joint exogeneity of all current and expected volume and terminal prices.

²⁴ Along with the city fixed effect for each city, these instruments use 23 degrees of freedom for each city. On average, there are 66 observations per city.

²⁵ The test statistic, distributed asymptotically normal, is below 1.0 for both the OLS and the 2SLS estimates of (2).

²⁶ It is natural to think that larger changes in crude oil prices would be associated with higher variance in the errors. The belief that higher margin observations would have lower variance comes from Borenstein and Shepard (1995), where we show that the adjustment rate of a city's terminal prices to crude oil shocks is a declining function of the city's average retail margin.

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5. Results

■ The OLS and two-stage least-squares estimates from equations (1) and (2) are reported in Table 3. In all specifications, the coefficient on expected volume is positive, as the Rotemberg-Saloner hypothesis predicts, and significantly different from zero at the 5% significance level or better. Using the coefficients from 2SLS estimation of equation (2), the elasticity of margin with respect to expected next-period volume is about .38 at mean margin and volume. The estimated effect of an expected change in terminal price is also consistent with the Rotemberg-Saloner hypothesis and is statistically significant at the 1% level. The elasticity of margin with respect to expected next-period terminal price is about -.36 at mean margin and terminal price, using the 2SLS results from (2).

In Figure 3 we have graphed the effects of volume changes on margins implied by the estimated two-stage coefficients on current and expected next-period volume from equation (2). The figure shows the national annual pattern for normalized volume (*NVOLUME*) and the estimated margin, normalized by mean margin. Because the changes in margin induced by changes in terminal and crude prices have been removed from the data graphed in Figure 3, it isolates the response of margins to changes in demand.²⁸ Movements in volume are estimated to cause margins to vary from about 95% of average margin in December to about 104% in June and July. The margin pattern in Figure 3 is consistent with the prediction that margins will be higher when near-term volume is increasing, holding current demand constant. For example, national average demand is approximately equal in April and October, but the increase in demand in May compared to the decline in demand in November causes estimated margins to be higher in April than in October. The estimates also imply that changes in the retail margin lead changes in volume over the demand cycle. Margin is positively correlated with volume, but it declines before the August demand peak in anticipation of the September volume decline, and rises before the January trough in anticipation of the February volume increase. This pattern is consistent with simulations conducted by Haltiwanger and Harrington that show a tendency for collusive price to drop (rise) before the demand peak (trough) even if price is generally procyclical.

The estimated effect of volume implies about a 9% variation in margins, or about one cent per gallon, over the seasonal cycle. This effect is not large in absolute magnitude, but its importance to tacitly colluding firms depends on the size of the operating margin. The margin we observe (retail price minus terminal price) averages 10.99 cents in our sample, but this overstates the true margin (retail price minus marginal cost), because true marginal cost is greater than the wholesale cost of gasoline. Delivery cost, for instance, is probably two to three cents per gallon,²⁹ reducing the economic margin to no more than about eight cents. Some of the labor costs are variable on a month-to-month basis for most stations, which would further reduce the economic margin.

²⁷ In unreported regressions, we correct the standard errors using White's procedure. The coefficient pattern is largely unaffected by this change in procedure. However, since White's correction gives consistent estimates of the standard errors, but does not improve the efficiency of the coefficient estimates, we report the results from this direct correction for heteroskedasticity.

²⁸ The pattern evident in Figure 3 is not apparent in a simple graph of margin on volume because a very large share of the variance in margins is the result of movements in crude oil prices. These effects must be removed to uncover the demand effects.

²⁹ DTW prices exceed terminal prices by about this amount.

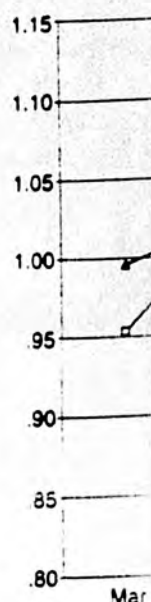
Table 3 Estimation of Equations (1) and (2)
Dependent Variable: *MARGIN_i*

	Equation (1)		Equation (2)	
	OLS	2SLS	OLS	2SLS
<i>NVOLUME_i</i>	.952 (1.223)	3.009 (1.600)	-.335 (1.211)	.690 (1.493)
<i>EXP NVOLUME_{i-1}</i>	3.220 (1.560)	3.927 (1.636)	4.314 (1.464)	4.158 (1.533)
<i>TERMINAL_i</i>	-.149 (.023)	-.058 (.035)		
<i>EXP TERMINAL_{i-1}</i>	-.062 (.016)	-.029 (.019)	-.061 (.017)	-.063 (.022)
<i>ΔTERMINAL_i</i>	-.271 (.015)	-.291 (.024)		
<i>ΔTERMINAL_i</i>			-.268 (.025)	-.179 (.043)
<i>ΔTERMINAL_{i-1}</i>			.154 (.029)	.162 (.028)
<i>ΔTERMINAL_{i-2}</i>			.073 (.026)	.078 (.027)
<i>ΔTERMINAL_i</i>			-.532 (.025)	-.553 (.050)
<i>ΔTERMINAL_{i-1}</i>			.174 (.026)	.162 (.028)
<i>ΔTERMINAL_{i-2}</i>			.074 (.025)	.074 (.025)
<i>ΔRETAIL_{i-1}</i>			-.038 (.027)	-.040 (.027)
<i>ΔRETAIL_{i-2}</i>			-.056 (.026)	-.052 (.026)
<i>ΔRETAIL_{i-1}</i>			-.047 (.027)	-.044 (.027)
<i>ΔRETAIL_{i-2}</i>			.023 (.023)	.017 (.024)
<i>RETAIL_{i-1}</i>			.610 (.018)	.606 (.018)
<i>TERMINAL_{i-1}</i>			-.605 (.027)	-.582 (.032)
<i>ρ</i>	.547 (.015)	.564 (.015)		
Observations	2,812	2,812	2,812	2,812
<i>R</i> ²	.634		.799	

Notes: Fixed time and city effects not reported. Heteroskedasticity-corrected asymptotic standard errors in parentheses. Equation (1) corrected for first-order serial correlation.

FIGURE 3

ESTIMATED EFFECT



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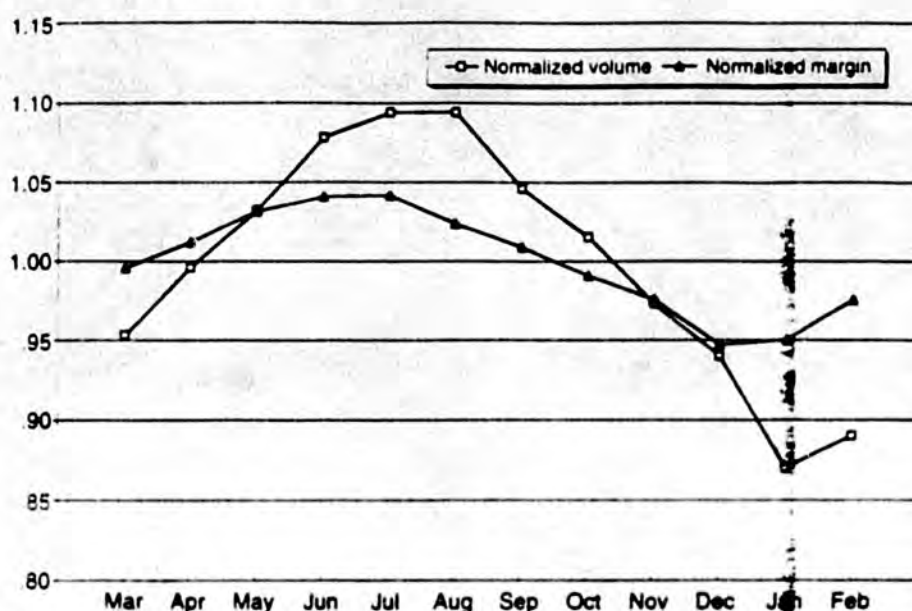
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FIGURE 3

ESTIMATED EFFECT OF VOLUME ON MARGIN



Overall, the proportional effect of volume changes on economic margins is probably at least 15%.

The estimated effect of $EXP_TERMINAL_{t-1}$ is most easily interpreted by considering the magnitudes of expected month-to-month changes in terminal price. The month-to-month expected change in terminal price (i.e., the expected terminal price in period $t + 1$ minus the actual terminal price in period t) in a city has a mean of about zero and a standard deviation of 4.84 cents. If terminal price is expected to increase by an amount equal to one standard deviation of the average expected change, current margin will be reduced by .30 cents compared to an expected change of zero.

The remaining estimates of the effects of lagged changes and levels of terminal and retail prices are consistent with previous research. The cumulative response function implied by these estimates exhibits asymmetric adjustment to terminal price changes: increases are passed through more quickly than decreases. This is consistent with the response found by Karrenbrock (1991), and the size of the asymmetry is very close to that found by Borenstein, Cameron, and Gilbert (1995) using national rather than city-level price data. The estimates also imply a passthrough rate that is not statistically distinguishable from 100%.³⁰

While the estimates in Table 3 allow for fixed city and time effects, we have maintained the assumption that the coefficients in equations (1) and (2) are equal across cities. This is a parsimonious approach, and we have no *a priori* reason to think that these coefficients would differ systematically. Nonetheless, this assumption imposes 210 restrictions on (1) and 630 restrictions on (2). It would not be surprising to find that standard tests reject pooling. Indeed, an *F*-test rejects the pooling in each equation. To investigate whether pooling has affected our results, we now relax these restrictions. Since there is no obvious way of grouping cities to test for meaningful subgroups, we estimated each equation allowing parameter values to differ for each of the 43 cities.

³⁰ See Borenstein, Cameron, and Gilbert (1995) for a description of the method used to construct the cumulative response function and to calculate the passthrough rate.

This approach uses up many degrees of freedom (leaving only about 50 degrees of freedom per city for estimation of (2)), and the estimates will be noisier than the restricted estimates. Nonetheless, removing all the restrictions has the advantage that the estimated coefficients cannot be affected by illegitimate pooling.³¹ The results for the expectation variables from unrestricted estimation of (2) are reported in Table 4 and confirm the pooled estimates reported in Table 3.

The first line of the table reports the means of the 43 OLS and 2SLS estimates of the coefficients on $EXP NVOLUME_{i,t-1}$ and $EXP TERMINAL_{i,t-1}$ parameters and the standard error of those means. The mean estimated effect of future expected volume is of the same sign as the restricted estimate reported in Table 3, but it is substantially larger. Similarly, the mean estimated effect of future expected terminal price is of the same sign as the restricted estimate in Table 3. Despite the loss in degrees of freedom, the means are statistically different from zero, except for the effect of future terminal price in the 2SLS estimation.

Table 4 also reports two additional tests of whether the pattern in the city-by-city parameter estimates is consistent with the restricted estimates in Table 3. The first is the Z-statistic. This statistic is the sum of the 43 *t*-statistics and is distributed asymptotically normal with mean zero and standard deviation of $\sqrt{43}$ under the null hypothesis that the sum of the *t*-statistics equals zero. The Z-statistic, which is commonly used in stock market event studies, is less heavily influenced by individual estimates with large standard errors than is the estimate of the mean. Below each of the Z-statistics, we show the level at which the statistic is significantly different from zero using a two-tailed test.³² The Z-statistics are all of the same sign as the coefficients in Table 3, and all are significantly different from zero at the 10% level or greater.

The final test is a simple binomial distribution: a count of the number of the 43 parameter estimates that have the expected sign. This approach has low power because it ignores considerable available information, but it is least likely to be influenced by individual cities. The counts shown in Table 4 indicate the high noise level in the individual city estimates, though the majority in each case are still of the hypothesized sign. In the 2SLS estimation, 60% of the coefficients for $EXP VOLUME_{i,t-1}$ are of the expected sign and 60% of the coefficients for $EXP TERMINAL_{i,t-1}$ are of the expected sign. Below each count we report the significance level (two-tailed) at which the frequency of "correct" signs is significantly different from the null of .5. Only the results from 2SLS estimation of the $EXP VOLUME_{i,t-1}$ coefficient are distinguishable from $p = .5$ using standard significance levels.³³

These results are consistent with the predictions of the tacit collusion models and inconsistent with standard noncollusive models where current margin is not a function of future expected demand or cost conditions. There are, however, two types of non-collusive models that can produce a linkage: models involving intertemporal switching costs and models of inventory behavior. We discuss these alternatives next.

³¹ For the unrestricted estimation, we continue to remove the common 72 time fixed effects. Thus for each city, every variable is measured as the deviation from its mean over all cities at the same point in time. The heteroskedasticity correction in each case was based on a common estimate of the effect of crude volatility on the variance in all cities. For the unrestricted estimation of (1), we estimated a common parameter of serial correlation ρ .

³² These and all of the significance tests in this table are carried out under the assumption that the city-by-city parameter estimates are uncorrelated across cities. This is valid because the 72 fixed time effects remove common shocks.

³³ The (unreported) results for the unrestricted estimation of equation (1) are similar to those reported in Table 4 for (2). The results for unrestricted estimation of (1) have the expected sign in all cases, are somewhat less significant than for (2) in the mean coefficients, about the same significance for the z-statistics, and more significant in the binomial tests.

Table 4 Summary of
Dependent

Mean parameter estimate
(standard error of mean)

Z-statistic
(P-value vs. $H_0: Z = 0$)

Binomial distribution (of 43)
(P-value vs. $p = .5$)

6. Possible alternative demand and cost

■ Repeat purchases over this period in a model in which consumers demand. Suppose that in the next period at the suppliers) want to attract industry demand is expected this period is higher than suppose the terminal less profitable and in this-period choices will be lower when the reverse of our em

A link between the result of firms re Inventories play a ve will be reflected in margin. For inventor must be held by sta significant inventory facts, then, must cor capacity and are kno

In the standard next period will incr Pindyck (1994) and today in anticipation be driven up. If they or into the retail pri

³⁴ The switching-cost demand is generated by a significant share of the demand from their usual location.

³⁵ The National Petroleum outlets in the United States, approximately 20,000 gallons per accept delivery more than

Table 4 Summary of Unconstrained Estimation of Equation (2)
Dependent Variable: MARGIN,

	EXP NVOLUME _{t,t-1}		EXP TERMINAL _{t,t-1}	
	OLS	2SLS	OLS	2SLS
Mean parameter estimate (standard error of mean)	9.844 (2.623)	10.154 (4.159)	-.053 (.018)	-.048 (.035)
Z-statistic (P-value vs. H ₀ : Z = 0)	17.90 (.01)	11.89 (.07)	-18.62 (.01)	-13.74 (.04)
Binomial distribution (of 43) (P-value vs. p = .5)	25 > 0 (.36)	26 > 0 (.22)	28 < 0 (.07)	26 < 0 (.22)

6. Possible alternative explanations for the effect of future demand and cost

Repeat purchases and consumer loyalty can create an incentive for firms to take actions this period in anticipation of future conditions. Klemperer (1987) presents a model in which consumer loyalty leads firms to choose prices to affect their future demand. Suppose that some kind of switching cost causes consumers to prefer buying next period at the station at which they buy this period. Then stations (and their suppliers) want to attract buyers in this period in order to sell to them next period. If industry demand is expected to increase next period, the incentive to attract customers this period is higher than if demand is expected to decline. Or, holding demand constant, suppose the terminal price were expected to rise. This would make a sale tomorrow less profitable and induce higher margins today. Thus, while this model does make this-period choices a function of expected next-period values, it implies that margins will be lower when demand is increasing and higher when cost is increasing. This is the reverse of our empirical findings.¹⁴

A link between current margins and anticipated market conditions could also be the result of firms responding to expected changes by altering their inventory levels. Inventories play a very important role in upstream petroleum markets, but these effects will be reflected in the terminal price and will not affect our analysis of the retail margin. For inventory effects to be important in determining retail margins, inventories must be held by station suppliers or station operators. Station operators do not hold significant inventory; they accept new deliveries every few days.¹⁵ Any inventory effects, then, must come from independent wholesalers. These jobbers have inventory capacity and are known to hold inventory against future demand and cost changes.

In the standard inventory models, a firm that expects demand to increase (decline) next period will increase (reduce) its inventory holdings this period (see, for example, Pindyck (1994) and Thurman (1988)). If, for example, jobbers increase their purchasing today in anticipation of higher demand tomorrow, this period's terminal prices might be driven up. If they do not fully pass this increase into the prices they charge stations or into the retail prices they directly control, then current margin will be reduced. This

¹⁴ The switching-cost explanation assumes that consumers are indeed loyal and that the increase in demand is generated by the same consumers in the same geographic market. If switching costs are low or a significant share of the seasonal increase in demand is generated by leisure travelers buying gasoline away from their usual locations, then there will be no intertemporal response due to consumer loyalty.

¹⁵ The National Petroleum Council estimates that total inventory capacity at the 170,000 retail gasoline outlets in the United States in 1989 was 3.49 billion gallons. This implies an average capacity of approximately 20,000 gallons per station. Stations sell about 200,000 gallons per month on average, so they must accept delivery more than ten times per month on average.

implies that higher demand tomorrow would lead to lower margins today. This prediction has the opposite sign to the one we find for future expected volume.³⁶

Inventory might also link current margins and expected future input prices. If, for example, jobbers believe that terminal prices will increase next period, they have an incentive to increase inventories this period. Holding inventories against expected input price fluctuation will have no effect on current margins, however, because the (opportunity) cost of marginal sales this period is the current terminal price. As long as wholesalers can purchase at the current terminal price, holding inventories may increase profits, but it should have no effect on the optimal retail margin for the current period.

It is possible, however, that transaction costs lead wholesalers to purchase only periodically,³⁷ so that the relevant opportunity cost is the terminal price they expect for the next transaction date. In that case, higher expected terminal prices could cause suppliers to increase the current price they charge to station operators who will, in turn, pass at least some of the increase into the retail price. This would lead to higher observed margins when wholesale prices are expected to increase. The true economic margin would be today's retail price minus the expected future terminal price, but the observed margin would be today's retail price minus today's terminal price. Inventories, then, might lead to a positive estimated effect of expected terminal price changes on current margins, the opposite of the effect that we find.

7. Conclusion

■ Using a panel of data on retail gasoline margins in 43 cities over 6 years, we have found evidence consistent with tacitly collusive pricing. Contrary to the predictions of standard noncooperative models, we find that margins respond to anticipated changes in demand and input prices. Furthermore, margins respond with the signs predicted by the Haltiwanger-Harrington extension of the Rotemberg-Saloner model to markets with deterministic demand cycles. *Ceteris paribus*, we find lower margins when demand is expected to decline next period than when it is expected to increase. The evidence for tacit collusion is particularly strong because we also find that margins respond to input cost changes in the predicted direction—margins are higher when wholesale prices are expected to decline next period than when they are expected to increase next period.

The results are somewhat surprising because the structure of the retail gasoline industry is not the tight oligopoly setting supposed by the formal models or investigated in prior empirical studies of collusion. They are somewhat less surprising when we recognize that evidence supporting tacitly collusive pricing is not evidence that the firms are able to set prices at, or even close to, the monopoly level. Indeed, given the inelastic industry demand for gasoline, it is quite clear that the actual margins fall far short of the monopoly level in this industry. The magnitude of the effect of tacit collusion on margins and the low elasticity of gasoline demand also imply that it will have little effect on welfare. Still, a simple structural analysis of retail gasoline markets might lead one to expect that any price above the one-shot Nash equilibrium level would be unsustainable. The dynamic pattern we observe in retail margins is inconsistent with this conclusion.

The dynamic pattern is consistent with formal models that assume firms are able to make sophisticated calculations to achieve the highest sustainable collusive price. In this

³⁶ Since we control for the lag structure in retail prices, we would uncover this inventory-induced linkage only if we have misspecified the lag structure. The point of the argument in the text is to make clear that the results we do find cannot be explained by inventory effects, not to argue that inventory effects don't exist.

³⁷ This might be the case if, for example, there were a fixed cost to making a purchase.

abstract world, all available collusive constraint is always world of gasoline retailing recognize that reducing the might reasonably expect to to higher margins even with of the retaliation. Recognize price if the resulting retail cost. Tacit collusion of

Appendix

■ Equation (2) is a straight line price is

$$RETAIL_t = \alpha + \beta \Delta RETAIL_t + \gamma \Delta RETAIL_{t-1} + \delta \Delta RETAIL_{t-2} + \epsilon_t$$

The terms involving lagged retail price in the regression, take

The extent to which prices de

If the next-period margin adjustment effect for period t would be α

The first term requires including $TERMINAL_t$ term requires including $TERMINAL_{t-1}$. Because we are interested in subtracting $TERMINAL_t$ from

$$MARGIN_t = \alpha + \beta \Delta MARGIN_t + \gamma \Delta MARGIN_{t-1} + \delta \Delta MARGIN_{t-2} + \epsilon_t$$

Subtracting $TERMINAL_t$ from $\Delta TERMINAL_t$ and $\Delta TERMINAL_{t-1}$ a negative $TERMINAL_{t-1}$ reintroduces these terms. The in the adjustment (Δ) terms.

Equation (A2) characterizes the effect of current demand equation reported in the box (A1) to (A2) are implicit.

abstract world, all available information is used, price wars never happen, and the collusive constraint is always binding. This cannot be taken as a serious description of the world of gasoline retailing. It is plausible, however, that station operators, for example, recognize that reducing their own prices induces price cutting at rival stations. They also might reasonably expect that once price cutting begins it will take some time to return to higher margins even without a clearly articulated strategy for the length and severity of the retaliation. Recognizing this, each seller might very well be less willing to cut price if the resulting retaliation will occur when market conditions make it particularly costly. Tacit collusion of this sort can produce the dynamic pricing pattern we find.

Appendix

■ Equation (2) is a straightforward variation on standard VAR models. A VAR model of changes in retail price is

$$\begin{aligned} \text{RETAIL}_t - \text{RETAIL}_{t-1} = & \beta_1 \Delta \text{TERMINAL}_t^* + \beta_2 \Delta \text{TERMINAL}_{t-1}^* + \beta_3 \Delta \text{TERMINAL}_{t-2}^* \\ & + \beta_4 \Delta \text{TERMINAL}_t^* + \beta_5 \Delta \text{TERMINAL}_{t-1}^* + \beta_6 \Delta \text{TERMINAL}_{t-2}^* \\ & + \beta_7 \Delta \text{RETAIL}_{t-1}^* + \beta_8 \Delta \text{RETAIL}_{t-2}^* + \beta_9 \Delta \text{RETAIL}_{t-3}^* \\ & + \beta_{10} \Delta \text{RETAIL}_{t-4}^* + \beta_{11} \text{RETAIL}_{t-1} + \beta_{12} \text{TERMINAL}_{t-1} + \epsilon_t. \end{aligned} \quad (\text{A1})$$

The terms involving lagged retail and terminal prices in levels are the error-correction term. To understand its role in the regression, take the equilibrium relationship between retail and terminal prices to be

$$\text{RETAIL} = \gamma_0 + \gamma_1 \text{TERMINAL}$$

The extent to which prices deviate from equilibrium in period $t-1$ would be

$$\text{RETAIL}_{t-1} - \gamma_0 - \gamma_1 \text{TERMINAL}_{t-1}$$

If the next-period margin adjusts toward the equilibrium by some factor ρ ($0 > \rho > -1$), the error-correction effect for period t would be $\rho(\text{RETAIL}_{t-1} - \gamma_0 - \gamma_1 \text{TERMINAL}_{t-1})$, which can be rewritten as

$$\rho \text{RETAIL}_{t-1} - \rho \gamma_0 - \rho \gamma_1 \text{TERMINAL}_{t-1}$$

The first term requires including RETAIL_{t-1} , the second term is subsumed in the fixed effects, and the third term requires including TERMINAL_{t-1} .

Because we are interested in retail margins, we rearrange terms in this equation, adding RETAIL_{t-1} and subtracting TERMINAL_{t-1} from both sides to get current retail margin on the left-hand side:

$$\begin{aligned} \text{MARGIN}_t = & (\beta_1 - 1) \Delta \text{TERMINAL}_t^* + \beta_2 \Delta \text{TERMINAL}_{t-1}^* + \beta_3 \Delta \text{TERMINAL}_{t-2}^* \\ & - (\beta_4 - 1) \Delta \text{TERMINAL}_t^* + \beta_5 \Delta \text{TERMINAL}_{t-1}^* + \beta_6 \Delta \text{TERMINAL}_{t-2}^* \\ & - \beta_7 \Delta \text{RETAIL}_{t-1}^* + \beta_8 \Delta \text{RETAIL}_{t-2}^* + \beta_9 \Delta \text{RETAIL}_{t-3}^* + \beta_{10} \Delta \text{RETAIL}_{t-4}^* \\ & + (\beta_{11} + 1) \text{RETAIL}_{t-1} + (\beta_{12} - 1) \text{TERMINAL}_{t-1} + \epsilon_t. \end{aligned} \quad (\text{A2})$$

Subtracting TERMINAL_t from the right-hand side of (1) requires subtracting one from the coefficients on $\Delta \text{TERMINAL}_t^*$ and $\Delta \text{TERMINAL}_{t-1}^*$, each of which contains a positive TERMINAL_t . Because each also contains a negative TERMINAL_{t-1} that has been removed, subtracting one from the coefficient on TERMINAL_{t-1} reintroduces these terms. The equivalence is not exact because the coefficients are allowed to be asymmetric in the adjustment (Δ) terms, but not in the error-correction term (TERMINAL_{t-1}).

Equation (A2) characterizes the autoregressive structure of prices. Augmenting it to take into account the effect of current demand and of expected demand and terminal price produces the basic estimating equation reported in the body of the article as equation (2), where the parameter adjustments to get from (A1) to (A2) are implicit.

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[Investments](#) • [Quote Plus](#) • [Portfolio](#) • [Stocks](#) • [Mutual Funds](#) • [Brokers](#) • [Insights](#)**MAPCO INC (MDA)**[Quote](#)[Charts](#)[News](#)[Snapshot](#)[Analysts](#)[Competitors](#)[Financials](#)[Full Report](#)[Mgt Discussion](#)[SEC Filings](#)[Profile](#)[Discuss MDA](#)Enter ticker symbol(s): [Get Profile](#)[Symbol Lookup](#)**Business Description : MAPCO INC****Location:**1800 S BALTIMORE AVE
TULSA
OK
74119**Ticker:** MDA**Exchange:** NYSE**Telephone:** 918-581-1800**SIC:** 2911 PETROLEUM REFINING**Cusip:** 56509710**Operations**

MAPCO Inc. ("MAPCO" or the "Company") is a diversified energy company which, through separate business units, is engaged in the transportation by pipeline of natural gas liquids ("NGLs"), anhydrous ammonia, crude oil and refined petroleum products; the transportation by truck and rail of NGLs and refined petroleum products; the refining of crude oil; the marketing of NGLs, refined petroleum products and crude oil; the trading of crude oil, refined petroleum products and NGLs; NGL processing; NGL storage; and the marketing of motor fuel and merchandise through convenience store operations. MAPCO was incorporated in Delaware in 1958 and has its principal executive offices in Tulsa, Oklahoma. For convenience of reference and simplification of this report, references herein to MAPCO or the Company include its subsidiaries or affiliates, unless the context requires otherwise.

During 1996, MAPCO sold its Coal segment and reorganized its NGL and Petroleum segments into the following business unit reporting structures:

Annual Figures : MAPCO INC

Balance Sheet Summary

	(Year) FY 1996	(Year) FY 1995
	US\$	US\$1000s
Cash	104,800	33,300
Securities	0	0
Receivables	373,700	239,300
Allowances	1,700	1,500
Inventory	109,600	117,100
Current Assets	619,100	685,800
Property and Equipment, Net	2,154,200	2,209,100
Depreciation	797,300	835,400
Total Assets	2,170,700	2,293,300
Current Liabilities	588,600	417,500
Bonds	608,400	801,000
Preferred Mandatory	0	0
Preferred Stock	0	0
Common Stock	63,000	62,900
Other Stockholders' Equity	540,600	579,400
Total Liabilities and Equity	2,170,700	2,293,300

Income Statement Summary

Total Revenues	3,353,100	3,310,000
Cost of Sales	0	0
Other Expenses	140,200	224,700
Loss Provision	0	0
Interest Expense	56,900	58,300
Income Pre Tax	214,400	114,200
Income Tax	82,800	37,200
Income Continuing	130,200	74,700
Discontinued	-32,700	0
Extraordinary	0	0
Changes	0	0
Net Income	97,500	74,700
EPS Primary	1.7\$	2.51\$
EPS Diluted	1.69\$	2.5\$

Quarterly Figures : MAPCO INC

Balance Sheet Summary

	9 Mos Ending 9/30/97 US\$1000s	6 Mos Ending 6/30/97 US\$1000s	3 Mos Ending 3/31/97 US\$
Cash	44,500	41,700	113,400
Securities	0	0	0
Receivables	325,000	298,300	284,100
Allowances	2,600	2,000	2,000
Inventory	164,900	153,200	120,300
Current Assets	567,500	525,200	542,100
Property and Equipment, Net	2,271,200	2,210,000	2,157,200
Depreciation	824,300	810,500	792,300
Total Assets	2,348,600	2,215,900	2,159,900
Current Liabilities	547,400	459,100	457,600
Bonds	763,000	757,900	698,100
Preferred Mandatory	0	0	0
Preferred Stock	0	0	0
Common Stock	63,200	63,100	63,100
Other Stockholders' Equity	594,200	558,800	558,700
Total Liabilities and Equity	2,348,600	2,215,900	2,159,900

Income Statement Summary

Total Revenues	2,767,600	1,785,500	931,200
Cost of Sales	0	0	0
Other Expenses	-70,300	-72,600	-70,600
Loss Provision	0	0	0
Interest Expense	38,000	26,700	12,100
Income Pre Tax	178,400	139,800	121,700
Income Tax	69,800	54,100	47,800
Income Continuing	105,500	83,400	72,700
Discontinued	0	0	0
Extraordinary	0	0	0
Changes	0	0	0
Net Income	105,500	83,400	72,700
EPS Primary	1.93\$	1.52\$	1.32\$
EPS Diluted	1.91\$	1.5\$	1.3\$

Mgt Discussion : MAPCO INC

Mgt Disc SEP 1997 Mgt Disc JUN 1997 Mgt Disc MAR 1997

[Dated SEP 1997]

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis may contain forward-looking statements, including, without limitation, statements relating to the Company's plans, strategies, objectives and expectations and are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Any such forward-looking statements involve known and unknown risks and uncertainties and the Company's actual results may differ materially from those forward-looking statements. The Company does not undertake to update, revise or correct any of the forward-looking information contained in this document. Readers are cautioned that such forward-looking statements should be read in connection with the Company's disclosures under the heading "CAUTIONARY STATEMENT FOR THE PURPOSES OF THE 'SAFE HARBOR' PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" beginning on page 29.

FINANCIAL CONDITION

Cash Generation

Nine months ended September 30,	1997	1996	Var.
Net cash provided by continuing operations	\$ 66	\$ 101	\$ (35)
Net cash provided by discontinued operations	--	22	(22)
Net cash provided by operating activities	66	123	(57)
Net cash provided by (used in) investing activities	(222)	156	(378)
Net cash provided by (used in) financing activities	96	(253)	349
Cash generation (usage)	\$ (60)	\$ 26	\$ (86)
	=====	=====	=====

The \$35 million decrease in funds provided by continuing operations in 1997 was primarily attributable to a \$28 million decrease in earnings from operations, adjusted for gain on sale of assets and changes in operating assets and liabilities. Decreased earnings in the Propane Marketing business unit were the primary cause of the decreased earnings from operations and were caused by weak market conditions during the first nine months of the year and increased operating costs associated with growth strategies. The net change in accounts payable for the nine months ended September 30, 1997, decreased \$85 million as compared to the change in accounts payable for the same period in 1996 primarily due to higher-cost year-end 1996 crude and propane purchases. The change in accrued taxes was a decrease of \$25 million due to timing differences in making required tax payments. Partially offsetting these uses of cash was a change in accounts receivable which decreased \$106 million, primarily reflecting lower product sales prices in the current year.

Cash provided by discontinued operations was from the operations of the Coal business through July 1996.

Cash flows from investing activities in 1997 included capital expenditures and acquisitions of \$175 million, of which \$50 million was for capital items necessary to maintain existing operations. Capital

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expenditures in 1997 (see the Liquidity and Capital Resources section of this report for additional details regarding the acquisitions discussed below) included \$35 million for the acquisition of various propane marketing businesses, \$18 million for the addition of a propylene splitter, expansion of the alkalization unit, replacement of the fluid catalytic cracker blower and an additional storage tank at the Mid-South Refinery, \$12 million for the acquisition of 19 convenience stores from EZ-Serve Inc., \$11 million for the acquisition of ACS Data LTD., \$7 million for the acquisition of the assets of Gas Supply Inc., \$6 million for a new computer system in the Propane Marketing business unit, \$5 million for a gasoline expansion project and initial costs associated with the addition of a third crude unit for expanded jet fuel production at the Alaska Refinery, and \$5 million for propane tanks. Expenditures for investments in unconsolidated affiliates during the first nine months of 1997 included \$106 million for the Discovery pipeline project, \$4 million for the Rio Grande pipeline project, and \$3 million for the Alliance pipeline project. Cash flows from investing activities in 1997 included proceeds of \$66 million from the sale of MAPCO's interest in the natural gas liquids and condensate in the West Panhandle field. Cash flows from investing activities during the first nine months of 1996 included \$236 million of proceeds from the sale of the Coal segment to Alliance Coal Corporation and \$43 million of proceeds from Retail Propane's sale of its Iowa propane and liquid fertilizer assets to CENEX. These proceeds were partially offset by \$89 million of capital expenditures for continuing operations, of which \$45 million was for capital items necessary to maintain existing operations. Capital expenditures in 1996 also include \$11 million for a saturated gas plant expansion at the Memphis Refinery, \$5 million for the acquisition of a propane company in Colorado, and \$4 million for the expansion of the Hobbs Station in west Texas. Capital expenditures in 1996 associated with the discontinued Coal segment were \$22 million. Investments in unconsolidated affiliates included \$19 million for the Rio Grande pipeline project.

Cash from financing activities in 1997 included the use of \$23 million in cash to reduce variable-rate borrowings, \$50 million to purchase 1.6 million shares of the Company's common stock and \$25 million for cash dividends. In the first quarter of 1997, MAPCO issued \$100 million of senior subordinated notes with a coupon rate of 7.25% that are due in 2009 and \$100 million of senior subordinated debentures with a coupon rate of 7.70% that are due in 2027. Cash used in financing activities for the first nine months of 1996 included the repurchase of 2.2 million shares of MAPCO common stock for \$62 million, the payment of \$22 million of cash dividends and a net decrease in variable rate debt of \$173 million.

Various loan agreements contain restrictive covenants which, among other things, limit the payment of advances or dividends by two of Natural Gas Liquids' ("NGL") subsidiaries to MAPCO. At September 30, 1997, \$190 million of net assets held by such subsidiaries were restricted by such provisions.

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LIQUIDITY AND CAPITAL RESOURCES

MAPCO's primary sources of liquidity are its cash and cash equivalents, internal cash generation, and external financing. At September 30, 1997, MAPCO's cash and cash equivalents were \$45 million compared to \$105 million at

December 31, 1996.

MAPCO's external financing sources include its bank credit agreements, its uncommitted bank credit lines, its ability to issue public or private debt, including commercial paper and its leasing arrangement. MAPCO's bank credit agreements represent a total committed line of credit of \$400 million. The bank credit agreement serves as a back-up for outstanding commercial paper and for borrowings against bank money market lines. As of September 30, 1997, no borrowings were outstanding under the bank credit agreement.

On December 11, 1996, the Company entered into a seven-year operating lease arrangement to accommodate the acquisition and construction of certain assets. Payments under the lease are based on the amounts spent for acquisition or construction of assets and the applicable interest rate. After the lease term, the arrangement may be extended by agreement of the parties or the Company may purchase or arrange for the sale of the assets. As of September 30, 1997, there were no outstanding advances against the lease agreement and the full \$100 million commitment was available. The Company expects to utilize \$15 million of the commitment by December 31, 1997.

As of September 30, 1997, MAPCO had outstanding \$279 million of Medium Term Notes issued pursuant to a 1990 shelf registration statement. The aggregate principal amount of \$47 million remaining on the 1990 shelf registration statement was de-registered on March 4, 1997. On January 31, 1997, MAPCO filed another shelf registration statement with the Securities and Exchange Commission providing for the issuance of up to \$500 million of debt and equity securities. During the first quarter of 1997, the Company issued \$200 million of senior subordinated notes and debentures under this registration statement. The proceeds from this debt issuance were used for general corporate purposes, including funding working capital requirements, capital expenditures, investments in unconsolidated affiliates, share repurchases and reduction of debt.

At December 31, 1996, the Company was a party to various interest rate swap agreements with financial institutions which effectively changed the Company's interest rate exposure from variable rates to fixed rates on \$100 million of debt. In the first quarter of 1997, the Company recognized a \$4.3 million gain upon termination of the interest rate swap agreements, which was done concurrently with the pay-off of the related debt.

As of September 30, 1997, the Company had sold put options on 1.1 million shares of MAPCO common stock with strike prices ranging from \$29.00 to \$32.63 per share. In the first nine months of the year, put options on 500,000 shares expired and options on 600,000 shares were extended. As of September 30, 1997, options on 600,000 shares of MAPCO

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common stock were outstanding with expiration dates ranging from October 1997 to February 1998. MAPCO's Board of Directors has authorized Management to issue put options on up to 1.5 million shares of MAPCO's common stock.

Effective January 1, 1997, MAPCO sold its interest in the natural gas liquids and condensate in the West Panhandle field to Westpan NGL Company, a subsidiary of MESA Operating Company, for \$66 million. The Company recognized

a gain of \$66 million on the transaction in the first quarter of 1997 as the interest sold had no book basis. As part of the sales agreement, MAPCO was released from its liability for its share of prior natural gas liquids over-takes.

Effective January 1, 1997, MAPCO acquired the assets of Gas Supply, Inc., ("Gas Supply") an independent wholesale propane company based in Minneapolis, Minnesota, for approximately \$7 million, plus working capital. The acquisition has been used to expand MAPCO's current wholesale propane marketing activities under the trade name "Gas Supply." Gas Supply marketed approximately 120 million gallons of propane in the Central and Northeastern United States in 1996. MAPCO also acquired Gas Supply's related product sales, a construction company, a 40,000-barrel storage facility and a rail car and truck terminal in Rosemont, Minnesota.

In April 1997, MAPCO acquired ACS Data, Ltd. ("ACS"), a company with headquarters in Manchester, England, at a cost of approximately \$10 million. ACS designs and manufactures hand-held computers and peripherals.

Effective May 21, 1997, MAPCO acquired 19 retail convenience stores located primarily in the Nashville, Tennessee market from EZ-Serve Inc. at a cost of \$12 million.

On April 30, 1997, MAPCO purchased a 5% ownership in the Alliance pipeline project. The Alliance pipeline will construct a 1,900 mile, 36-inch diameter, natural gas pipeline transmission system to carry natural gas and natural gas liquids from western Canada to the Midwest United States for marketing throughout North America. Alliance's delivery points near Chicago include a natural gas liquids extraction facility proposed by Aux Sable Liquids Products LP, which is adjacent to the northern end of MAPCO's 10,000 mile NGL pipeline network. Construction of the pipeline is expected to begin in the second quarter of 1998 with completion anticipated by year-end 1999.

From May through August 1997, MAPCO acquired eleven propane companies at a cost of approximately \$35 million. These companies, with combined sales during 1996 of over 26.5 million gallons of propane and other related products, have market areas in Alabama, Arkansas, Indiana, Minnesota, Missouri, North Carolina, Oklahoma and South Dakota.

MAPCO's existing debt and credit agreements contain covenants which limit the amount of additional indebtedness the Company can incur. Management believes, however, that MAPCO has sufficient capacity to

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fund its anticipated needs.

Capital expenditures in 1997 are currently expected to be about \$315 million and investments in unconsolidated affiliates are projected to be approximately \$140 million. Capital expenditures in 1997 are currently expected to include \$83 million for capital items necessary to maintain existing operations, \$60 million for propane marketing acquisitions and expansions, \$60 million for convenience store construction and acquisitions, \$46 million for refinery expansion projects and \$22 million for pipeline loops and connections. MAPCO expects to utilize cash from operations, short-term funding sources, proceeds from the sale of assets, leasing arrangements and proceeds from additional

borrowings and/or equity securities under the shelf registration statement filed with the SEC in 1997 to meet anticipated 1997 capital expenditures and equity investments. MAPCO anticipates that any future excess internal cash generation will be used primarily for debt reduction and to fund new capital projects.

Other Developments

On July 22, 1997, MAPCO announced plans to construct a splitter at the Mid-South Refinery that will increase the refinery's capacity for propylene production from the current 2,000 barrels per day to 6,000 barrels per day of the high margin product. The project is expected to be completed by the end of the first quarter of 1998 at an anticipated cost of \$20 million.

MAPCO also announced plans to construct a third crude unit at the North Pole Refinery that will produce an additional 17,000 barrels per day of refined products, including 14,000 barrels per day of jet fuel. The project is expected to be completed in the fourth quarter of 1998 at a cost of \$70 million.

On August 1, 1997, MAPCO announced that it had reached an understanding with Enterprise Products Company ("Enterprise") to form a joint venture for the development of a natural gas liquids transportation and distribution system. It is anticipated this system will be capable of distributing product from key NGL sources in southern Louisiana with direct connections to major NGL markets, including the Louisiana river markets, Lake Charles, Louisiana and Mont Belvieu, Texas. The joint venture will be a limited liability company in which MAPCO and Enterprise will each have a 50 percent interest.

On September 5, 1997, MAPCO announced the opening of its new office under the name of Espagas, S.A. de C.V. ("Espagas") in Celaya, Guanajuato, Mexico and future plans to open an additional office in Mexico City. Espagas markets liquefied gas (LPG) technology equipment as a part of MAPCO's TouchStar Technologies LLC.

MAPCO announced on September 10, 1997 that Thermogas Company had launched a new company, Thermogas Energy, LLC, that will form joint ventures with rural electric cooperatives and municipal utilities to market and distribute propane. As of September 30, 1997, Thermogas

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Energy had completed joint ventures with two rural cooperatives in the state of Kentucky.

The gas gathering system for the Discovery project is under construction and gas transportation is expected to begin in December 1997. The project's gas processing plant and fractionator are also under construction and both are expected to be fully operational by July 1998.

In July 1997, MAPCO acquired a 100% ownership interest in LEXAS OIL, L.L.C. which had been an unconsolidated 50% owned entity since January 1, 1995.

The Company is in the process of assessing the expected costs associated with modifying its internal-use software and hardware for the year 2000, and has not yet determined the estimated amount of such costs. MAPCO is also reviewing the potential costs or consequences of incomplete or untimely resolution of the year 2000 issue by the Company or other entities, which could materially impact results of operations, financial position or cash flows.

RESULTS OF OPERATIONS

THIRD QUARTER

Sales and operating revenues were as follows (In millions):

	Three Months Ended September 30,		
	1997	1996	Variance
Natural Gas Liquids	\$ 170.0	\$ 161.6	\$ 8.4
Propane Marketing	66.5	71.7	(5.2)
Petroleum Refining	651.3	466.0	185.3
Retail Petroleum	187.7	186.8	0.9
Other	8.3	--	8.3
Eliminations	(101.7)	(88.6)	(13.1)
	<u>\$ 982.1</u>	<u>\$ 797.5</u>	<u>\$ 184.6</u>
	*****	*****	*****

The \$184.6 million increase in sales and operating revenues primarily reflects increased sales in the Petroleum Refining business unit.

Natural Gas Liquids' sales increased \$8.4 million principally due to increased trading and pipeline revenues. Trading revenues increased \$5.5 million as revenues from the Canadian operations, which just began operations last September, increased \$19.5 million, offset by a \$14.0 million decrease in other trading activities. Other trading revenues decreased as both volumes and prices decreased from last year. Pipeline revenues were at record levels for the third quarter and increased \$4.2 million, primarily due to increased shipments from Rocky Mountain origins, increased production and shipments from the Chaco plant and increased shipments of ethane/propane mix products. The Westpan operations, which were shut down after MAPCO sold its interest in the liquids and condensate in the West Panhandle field on January 1, 1997, generated \$1.9 million of revenues during the third quarter of 1996. Outside storage revenue increased \$0.4 million due to increased storage contracts. Overall, Natural Gas Liquids' \$13.3 million volume increase was partially offset by a \$4.9 million price decrease for a net sales increase of \$8.4 million.

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Propane Marketing sales decreased \$5.2 million as decreased gas supply sales more than offset the impact of increased retail sales. Retail sales increased \$2.3 million as increased retail propane sales more than offset the loss of

revenues from fertilizer and chemical sales. Retail propane sales increased \$4.1 million as volumes increased 5.2 million gallons reflecting the additional plants acquired since last year combined with slightly higher selling prices. Fertilizer and chemical sales decreased \$1.7 million because those operations were phased-out during the third quarter of 1996. Gas supply sales decreased \$7.7 million primarily due to decreased spot supply sales. The decrease in spot supply sales was mainly attributable to decreased sales volumes of 18.9 million gallons combined with a slight decrease in sales prices. Last year's volatile market conditions were favorable for spot supply activities. Overall, a \$12.6 million decrease in prices was partially offset by a \$7.4 million increase in volumes for a net sales decrease of \$5.2 million.

Petroleum Refining sales increased \$185.3 million primarily due to increased sales by the Mid-South Refinery. Sales at the Mid-South Refinery increased \$199.6 million as volumes increased 100,424 barrels per day (73.8%), partially offset by a 7.6% decrease in average sales prices. The sales volume increase was met by increased production, as processed barrels sold increased 19,656 barrels per day, and sales of purchased products increased by 80,768 barrels per day. The increase in sales volume reflects the inclusion of the previously unconsolidated Lexas operations, increased demand for high-octane gasoline, increased jet fuel sales, and aggressive marketing and increased spot sales in the Memphis and Ohio Valley areas. Petroleum Refining's sales decreased \$14.3 million as average sales prices decreased \$0.05 per barrel (5%) and sales volumes decreased 1,796 barrels per day (3.3%). The price decrease primarily reflects lower jet fuel and diesel prices and the volume decrease was due to the timing of gasoline blendstock cargo shipments. Overall, Petroleum Refining's \$234.7 million volume increase was offset by a \$49.4 million price decrease for a net sales increase of \$185.3 million.

Retail Petroleum's overall sales increased \$12.9 million due to a \$9.3 million increase in merchandise sales, partially offset by a \$8.4 million decrease in fuel sales. Lower sales prices accounted for \$3.5 million of the \$8.4 million decrease in fuel sales and decreased volumes accounted for the remaining \$4.9 million. Merchandise sales increased \$9.3 million (16.9%) due to the combination of an increase of 20 stores over the prior year quarter and a 7.6% increase in merchandise sales per store. Gasoline revenues increased \$1.0 million reflecting an increase of 2.0 million gallons (2.8%) in sales volumes, partially offset by a \$0.02 per gallon (1.6%) decrease in average sales price per gallon. The increase in gasoline sales volumes was primarily attributable to the increased number of stores. Diesel revenues decreased \$9.5 million as both prices and volumes decreased from last year. Volumes declined 6.7 million gallons (16.9%) because of the absence of volumes from the Rising Fawn travel center which closed due to a fire in the fall of 1996 and the discontinuation of the Fuelman operations. Construction to rebuild the Rising Fawn travel center is

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underway and is expected to be completed by early December 1997. Diesel prices decreased \$0.06 per gallon (5.5%).

Other sales and operating revenues include sales by MAPCO's newly formed companies FleetOne L.L.C. and TouchStar Technologies L.L.C. of \$5.8 million and \$2.5 million, respectively.

Outside purchases and operating expenses increased \$176.9 million in the third quarter of 1997 as compared to 1996. Details by business unit are as follows (In millions):

	1997		Three months ended September 30: 1996		Variance	
	Outside Purchases	Operating Expense	Outside Purchases	Operating Expense	Outside Purchases	Operating Expense
Natural Gas Liquids	\$ 99.4	\$ 27.1	\$ 86.3	\$ 31.4	\$ 13.1	\$ (4.3)
Propane Marketing	13.1	23.0	33.7	17.9	(20.6)	5.1
Petroleum Refining	580.6	27.7	413.9	25.6	166.7	2.1
Retail Petroleum	85.0	26.1	83.3	18.7	1.7	7.4
Other	5.9	(.2)	--	--	5.9	(.2)
	<u>\$ 784.0</u>	<u>\$ 103.7</u>	<u>\$ 617.2</u>	<u>\$ 93.6</u>	<u>\$ 166.8</u>	<u>\$ 10.1</u>

Natural Gas Liquids' outside purchases increased \$13.1 million primarily as a result of increased trading purchases. Canada trading purchases increased \$19.4 million as those operations were in start-up in the 1996 third quarter. Other trading purchases decreased \$6.3 million primarily due to lower market prices. Operating expenses decreased \$4.3 million primarily due to the absence of Westpan expenses as those operations were shut down after MAPCO sold its interest in the liquids and condensate in the West Panhandle field in January of this year.

Propane Marketing's outside purchases decreased \$20.6 million due to reduced wholesale, retail propane and fertilizer purchases. Propane purchases for the wholesale and retail operations decreased \$20.2 million. Lower product prices accounted for \$28.0 million of the variance, partially offset by increased volumes, reflecting the volume increase in both retail and wholesale propane sales. Outside purchases of fertilizer and chemical decreased \$1.3 million due to the divestiture of those product lines in 1996. Appliance and all other purchases increased \$0.9 million. Operating expenses increased \$5.1 million primarily due to increased salary and benefit costs, advertising, supplies and vehicle expenses associated with acquisitions and new development and increased bad debt accruals associated with increased accounts receivable.

Petroleum Refining's outside purchases increased \$166.7 million. The Mid-South Refinery's purchases increased \$183.3 million due to increased purchases of refined products and increased crude throughput volumes, partially offset by a decrease in crude prices. Outside purchases of refined products increased due to the inclusion of the previously unconsolidated Lexus trading operations and an overall increase in sales in the Mid-South Refinery's marketing areas. The

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Alaska Refinery's outside purchases decreased \$16.6 million reflecting a \$2.67 per barrel decrease in West Coast crude prices combined with reduced purchases of refined products as product sales volumes were down for the quarter. Operating expenses increased \$2.1 million primarily due to increased labor and maintenance costs at the

Alaska Refinery. Operating expenses at the Mid-South Refinery were essentially unchanged from last year; however, because of the additional barrels produced, controllable expenses decreased \$0.12 per barrel (6.9%).

Retail Petroleum's outside purchases increased \$1.7 million. Including the more significant amounts of products purchased from the Petroleum Refining business unit, which are not reflected in the above table due to eliminations, total purchases increased \$0.6 million. Gasoline purchases increased \$3.3 million due to an increase in volumes of 4.6 million gallons combined with a \$0.01 per gallon increase in wholesale prices. Merchandise purchases increased \$6.4 million due to increased sales. Total diesel purchases decreased \$9.1 million due to a decrease of 4.7 million gallons purchased, reflecting lower diesel sales volumes, combined with a \$0.07 per gallon decrease in wholesale costs. Operating expenses increased \$7.4 million principally because of general cost increases reflecting the increased number of stores in operation and business development activities.

Other outside purchases of \$5.9 million include purchases of refined petroleum products by FleetOne L.L.C. of \$4.5 million and computer product purchases by TouchStar Technologies L.L.C. in the amount of \$1.4 million.

Selling, general and administrative expenses increased \$4.8 million; however, excluding a \$4.0 million reclassification entry which reduced general and administrative expense (see other income below), selling, general and administrative expense increased \$8.8 million. The increase was primarily due to increased labor and associated costs reflecting increased support personnel, the cost of the Marketing and Business Development department which was established in August 1996 to develop new business opportunities for the Company, and increased outside services, legal and travel expenses.

Depreciation and amortization expense increased \$3.5 million primarily because of increased expense by Alaska Marketing and Refining and Propane Marketing. Alaska Marketing and Refining's increase was due to an adjustment in September 1996 to increase the depreciable life of the refinery which reduced prior year expense by \$3.1 million. Propane Marketing's depreciation expense increased principally because of plant acquisitions since last year.

Interest expense for the current quarter was \$11.3 million compared to \$15.1 million in the 1996 quarter. The \$3.8 million decrease primarily reflects \$3.4 million of interest capitalized in the current quarter which was associated with the Discovery Project.

Other income/expense for the three months ended September 30 decreased

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\$4.3 million principally due to the current quarter reclassification of pension overfunding earnings from other income to general and administrative expense.

The effective income tax rate for the third quarter of 1997 was 40.7% compared to 40.6% in the third quarter of 1996. The difference between the statutory Federal income tax rate of 35% and the effective income tax rate was primarily due to state income taxes.

Operating profit (loss) for the three months ended September 30, 1997 and 1996 is detailed below (in millions):

	1997	1996	Variance
Natural Gas Liquids	\$ 32.2	\$ 32.6	\$ (0.4)
Propane Marketing	(10.0)	(5.1)	(4.9)
Petroleum Refining	33.2	20.4	12.8
Retail Petroleum	3.4	11.3	(7.9)
Other	(1.2)	-	(1.2)
	\$ 57.6	\$ 59.2	\$ (1.6)

Natural Gas Liquids' current quarter operating profit decreased \$0.4 million principally due to the absence of \$3.5 million of operating profit from the Westpan operations. MAPCO sold its interest in the liquids and condensate in the West Panhandle field in January 1997. Excluding Westpan from the 1996 results, operating profit increased \$3.1 million primarily due to increased profits from pipeline operations.

Propane Marketing's operating profit decreased \$4.9 million because increased margins on product sales were more than offset by increased operating, general and administrative and depreciation expenses.

Petroleum Refining's operating profit increased \$12.8 million, reflecting a \$15.2 million increase from the Mid-South Refinery, partially offset by a \$2.4 million decrease from the Alaska Refinery. Profits at the Mid-South Refinery increased primarily due to a 10.8% increase in the gross profit margin on processed barrels sold. The profit margin increase resulted from crude cost decreases which outpaced declines in average product sales prices. The \$2.4 million decrease in the Alaska Refinery's profit was primarily attributable to increased depreciation expenses. The impact of a 13.5% increase in gross profit margin on processed barrels sold was offset by increased operating expenses. The increase in gross profit margin reflects the effect of crude costs declining more than the average product price.

Retail Petroleum's operating profit decreased \$7.9 million primarily due to a \$7.4 million increase in operating expenses. Otherwise, an increase in merchandise profits of \$2.8 million was offset by lower gasoline profits. Diesel profits were essentially unchanged from the 1996 quarter. Merchandise profits increased because of a \$9.2 million

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Increase in sales volumes while gross profit margins remained unchanged from the 1996 quarter. Expenses increased primarily because of general increases in a number of expense categories and the impact of the additional stores from the EZ-Serve acquisition on operating costs. The lower gasoline profits reflect a 4.4 cent per gallon (21.6%) decrease from last year's exceptionally high margins, partially offset by a 2.8% increase in gasoline sales volumes. Diesel profits were essentially unchanged as the impact from a \$0.02 per gallon increase (29.1%) in gross profit margin was offset by a 6.7 million gallon (16.9%) decrease in volumes.

Income from continuing operations was \$22.1 million or \$0.41 per share in the 1997 third quarter compared to \$22.7 million or \$0.40 per share in the 1996 quarter. Average common shares outstanding were 54.4 million in the 1997 quarter and 57.3 million in the 1996 quarter.

YEAR-TO-DATE

Sales and operating revenues were as follows (In millions):

Nine Months Ended September 30,	1997	1996	Variance
Natural Gas Liquids	\$ 552.1	\$ 463.7	\$ 88.4
Propane Marketing	284.3	275.7	8.6
Petroleum Refining	1,645.6	1,285.3	360.3
Retail Petroleum	549.4	532.5	16.9
Other	14.9	-	14.9
Eliminations	(278.7)	(235.5)	(43.2)
	\$ 2,767.6	\$ 2,321.7	\$ 445.9

The \$445.9 million increase in sales and operating revenues was due to increased sales by all of MAPCO's operating units.

Natural Gas Liquids' sales increased \$88.4 million due to increased trading and pipeline revenues. Trading revenues increased \$83.2 million as revenues from MAPCO Canada, which just began operations last September, increased \$51.3 million. Other trading revenues increased \$31.9 million as both volumes and average prices increased over 1996. Pipeline revenues increased \$10.5 million, primarily due to increased ethane shipments from Rocky Mountain and Hobbs origins, increased production and shipments from the Chaco plant and increased shipments of ethane/propane mix products. The Westpan operations, which were shut down after MAPCO sold its interest in the liquids and condensate in the West Panhandle field on January 1, 1997, generated \$5.9 million of revenues during the first nine months of 1996. Overall, \$63.0 million of Natural Gas Liquids' sales increase was due to increased volumes and \$25.4 million was due to higher prices.

Propane Marketing sales increased \$8.6 million; however, excluding the revenues associated with the assets sold in the Cenex transaction, sales increased \$32.3 million as both Gas Supply and Retail Propane sales increased over 1996. The Cenex transaction included the sale of

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all of Propane Marketing's Iowa retail propane plants at the end of the first quarter of 1996 along with phased-out sales of its fertilizer and related products operations through the third quarter of 1996. Gas supply sales increased

\$25.4 million primarily due to increased wholesale propane sales reflecting the acquisition of the assets of Gas Supply Inc. in January 1997. Retail propane sales increased \$6.9 million reflecting a 10.5 cent per gallon increase in average sales prices, partially offset by a 14.0 million gallon decrease in sales volumes. The lower retail propane sales volumes reflect warmer weather patterns in the current year. Overall, \$21.8 million of Propane Marketing's \$32.3 million sales increase was attributable to increased prices and \$10.5 million to increase volumes.

Petroleum Refining sales increased \$360.3 million reflecting increased sales by both the Mid-South and Alaska Refineries. Sales at the Mid-South Refinery increased \$345.8 million (36.6%) as increased volumes more than offset the impact of lower product prices. Volumes increased 52,066 (38.0%) barrels per day reflecting increased demand for high-octane gasoline, increased jet fuel sales, and aggressive marketing and increased spot sales in the Memphis and Ohio Valley areas. The volume increase was met by increased production, as processed barrels sold increased 8,556 barrels per day (8.5%) combined with increased sales of purchased products of 43,510 barrels per day. Average product prices for the period decreased \$0.17 per barrel (0.7%). Sales increased \$14.5 million (1.3%). The increased volumes primarily reflect continued strong demand for jet fuel which more than offset decreased gasoline, diesel and asphalt sales. With this year's construction season almost complete, traditionally high-margin asphalt sales have been reduced by almost 40% due to the entry of new competitors in the Alaska asphalt market. Total processed sales volumes were met through increased sales of purchased products. Barrels sold increased 52,066 barrels per day. Overall, Petroleum Refining's \$364.4 million volume increase was offset by a \$4.1 million price decrease for a net increase of \$360.3 million.

Retail Petroleum's overall sales increased \$16.9 million due to a \$12.6 million increase in merchandise sales and a \$4.3 million increase in fuel sales. The increase in fuel sales was attributable to higher average fuel prices as the impact from volumes was negligible because increased gasoline volumes offset the impact of lower diesel volumes. Merchandise sales increased \$12.6 million (8.0%) due to the combination of an increase of 10 stores over the previous year and a 3.3% increase in merchandise sales per store. Gasoline revenues increased \$13.4 million reflecting an increase in gasoline volumes sold of 8.9 million gallons (4.3%) combined with a \$0.01 per gallon (0.8%) increase in average sales price per gallon. The increase in gasoline sales volumes was primarily attributable to an increase in the number of stores. Diesel revenues decreased \$9.8 million as decreased volumes more than offset the impact of higher sales prices. Volumes declined 10.7 million gallons (9.5%) because of the absence of volumes from the Rising Fawn travel center which closed due to a fire in the fall of

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1996, the discontinuation of the Fuelman operations and the increase in fuel prices. Diesel prices increased \$0.02 per gallon (5.5%) from last year.

Other sales and operating revenues includes sales by MAPCO's newly formed companies FleetOne L.L.C. and TouchStar Technologies L.L.C. of \$9.1 million and \$5.8 million, respectively.

Outside purchases and operating expenses increased \$443.7 million in the first nine months of 1997 as compared to 1996. Details by business unit are as follows (in millions):

	1997		Nine months ended September 30, 1996		Variance	
	Outside Purchases	Operating Expense	Outside Purchases	Operating Expense	Outside Purchases	Operating Expense
Natural Gas Liquids	\$ 337.1	\$ 85.9	\$ 243.7	\$ 85.7	\$ 93.4	\$ 0.2
Propane Marketing	131.2	68.4	141.1	59.8	(9.9)	8.6
Petroleum Refining	1,461.3	79.2	1,146.1	73.5	315.2	5.7
Retail Petroleum	249.6	70.0	241.5	59.6	8.1	10.4
Other	10.9	1.1	-	-	10.9	1.1
	\$ 2,190.1	\$ 304.6	\$ 1,772.4	\$ 278.6	\$ 417.7	\$ 26.0

Natural Gas Liquids' outside purchases increased \$93.4 million primarily as a result of increased trading purchases. Purchases by MAPCO Canada, which was in start-up during the 1996 quarter, increased \$51.3 million and other trading purchases increased \$41.9 million, reflecting both higher market prices and increased trading volumes. Operating expenses were essentially unchanged; however, excluding Westpan expenses from the 1996 amounts, operating expenses increased \$6.9 million. Pipeline expenses increased \$3.8 million due to increased power costs which resulted from both increased volumes and higher natural gas prices, partially offset by decreased property tax expense. Fractionation costs increased \$0.8 million because of increased volumes and higher natural gas prices. Operating expense associated with trading operations increased \$1.4 million.

Propane Marketing's outside purchases decreased \$9.9 million; however, excluding the Cenex transaction, outside purchases increased \$6.8 million. Propane purchases for both the wholesale and retail operations increased \$1.6 million as increased volumes caused purchases to increase \$21.4 million, partially offset by lower product prices which reduced purchases by \$19.8 million. Appliance purchases increased \$2.9 million and all other purchases increased \$2.3 million. Operating expenses increased \$8.6 million; however, excluding the Cenex transaction, operating expenses increased \$11.7 million. The increase was primarily due to increased salary and benefit costs and increased supplies and outside services attributable to acquisitions and retail plant development and accruals associated with contingent liabilities.

Petroleum Refining's outside purchases increased \$315.2 million. The Mid-South Refinery's purchases increased \$305.3 million due primarily

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to additional purchases of refined product to meet sales demand and increased purchases of crude caused by increased crude throughput. Refined product purchases increased 43,509 barrels per day (54.4%) and crude throughput barrels increased 8,992 barrels per day (8.29%). The increase in purchased volumes of refined products and crude was partially offset by lower product and crude prices. Alaska's outside purchases increased \$9.9 million

primarily due to increased purchases of jet fuel. Demand for jet fuel has exceeded the refinery's current production capacity and outside purchases of jet fuel have been required to meet increased sales contracts. Higher product prices also contributed to the overall increase in outside purchases. Operating expenses increased \$5.7 million. Expenses at the Alaska Refinery increased \$4.4 million due to planned increases in maintenance activities, including a mini-turnaround on the Sulfolane unit and maintenance on the crude tank and heat exchangers and increased environmental costs. Expenses at the Mid-South Refinery increased \$1.3 million primarily due to increased benefit costs.

Retail Petroleum's outside purchases increased \$8.1 million. Including the more significant amounts purchased from the Petroleum Refining business unit, which are not reflected in the above table due to eliminations, purchases increased \$16.9 million. Gasoline purchases increased \$17.6 million due to an increase of 11.4 million gallons (5.6%) of gasoline purchased combined with a \$0.04 per gallon (3.9%) increase in product cost. The volume increase primarily reflects increased sales volumes, partially due to the 19 additional stores from the EZ-Serve acquisition in the second quarter of 1997. Diesel purchases decreased \$10.0 million due to a decrease in volumes purchased of 9.7 million gallons (9.0%), which was partially offset by a \$0.01 per gallon (1.0%) increase in wholesale diesel prices. Merchandise purchases increased \$9.3 million (8.5%) as a result of the increased merchandise sales. Operating expenses increased \$10.4 million principally because of additional labor and other cost increases associated with the implementation of strategic growth plans, which include an increased number of stores from the EZ-Serve acquisition and other smaller acquisitions.

Other outside purchases of \$10.9 million reflect \$7.7 million of refined product purchases by FleetOne L.L.C. and \$3.2 million of computer product purchases by TouchStar Technologies L.L.C.

Selling, general and administrative expenses increased \$17.1 million; however, excluding a \$4.0 million reclassification overfunded pension asset income from other income to general and administrative expense, selling, general and administrative expense increased \$21.1 million. The increase was primarily due to increased labor and associated costs reflecting the increased number of employees and establishing, in August 1996, the Marketing and Business Development department to develop new business opportunities for the Company and increased outside services, legal and travel expenses.

Interest expense for the nine months ended September 30, decreased \$6.7 million. Capitalized interest, primarily associated with the Discovery

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Project, increased \$4.1 million over the same period in 1996. Interest expense on commercial paper and the ESOP loan decreased \$8.8 million and \$0.3 million, respectively, but these decreases were mostly offset by a \$2.6 million increase in interest expense on medium term notes and a \$4.4 million increase in interest expense from the 30-year bonds issued in February 1997. The decrease in expense on commercial paper and the ESOP loan reflect reduced average amounts of debt outstanding compared to the same period in 1996. Interest on the medium term notes

Increased due to the 12-year bonds which were issued in 1997. The \$66.0 million gain on the sale of net assets held for sale in 1997 reflects the gain on sale of MAPCO's interest in the liquids and condensate in the West Panhandle field in the first quarter. The \$20.8 million gain in 1996 was the gain on sale of the fertilizer and Iowa propane operations.

Other income/expense in the first nine months of 1997 includes a \$4.3 million gain on the termination of interest rate swap agreements and investment income from a portion of the proceeds from the Coal and Westpan sales. Other income/expense in 1997 also includes \$1.0 million of equity income from the Juarez pipeline and \$1.5 million of coal-related pension expense. Other income/expense in 1996 includes \$2.5 million of interest income associated with the sale of the Coal segment and a \$2.5 million gain on the sale of a corporate airplane, partially offset by expenses related to certain coal liabilities which were retained by MAPCO.

The effective income tax rate for the first nine months of 1997 was 39.1% compared to 37.8% for same period in 1996. The difference between the statutory Federal income tax rate of 35% and the effective income tax rate was primarily due to state income taxes.

Operating profit for the nine months ended September 30, 1997 and 1996 is detailed below (in millions):

	1997	1996	Variance
	-----	-----	-----
Natural Gas Liquids	\$ 161.9	\$ 97.6	\$ 64.3
Propane Marketing	(5.5)	41.9	(47.4)
Petroleum Refining	72.9	40.9	32.0
Retail Petroleum	12.3	25.6	(13.3)
Other	(4.7)	-	(4.7)
	-----	-----	-----
	\$ 236.9	\$ 206.0	\$ 30.9
	=====	=====	=====

Natural Gas Liquids' operating profit for the first nine months of 1997 includes a \$66.0 million gain on the sale of MAPCO's interest in the liquids and condensate in the West Panhandle field. Operating profit in 1996 includes \$12.4 million from the Westpan operations. Excluding the gain on sale from 1997 and Westpan's operating income from 1996, operating profit increased \$10.7 million, primarily as a result of increased profits from the pipeline operations. The improvement in pipeline profits reflects strong revenues resulting from favorable ethane recoveries and a full nine months of operations on the Rocky

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Mountain extension compared to last year's first quarter start-up of that line.

Propane Marketing's operating profit in the first nine months of 1996 included a \$20.8 million gain associated with

the Cenex transaction and \$2.7 million of profit from operating the assets included in that sale. Excluding this gain and the income from those divested assets, operating profit decreased \$23.9 million. The decrease in operating profit was attributable to lower margins, decreased retail volumes and increased expenses. The decrease in margins was primarily due to the volatility of propane market prices during the first quarter of 1997. Although margins have subsequently improved, overall margins for the year are still below the exceptional margins experienced during 1996. The decreased retail sales volumes were attributable to the warmer weather conditions in the first nine months compared to record cold temperatures last year.

Petroleum Refining's operating profit increased \$32.0 million as increased profits from the Mid-South Refinery were partially offset by slightly lower profits at the Alaska Refinery. Increased profits at the Mid-South Refinery of \$33.2 million were due to increased sales volumes of 52,066 barrels per day (38.0%) and a \$1.06 per barrel (46.4%) increase in the gross margin on processed barrels sold. Sales volumes increased due to increased demand for high-octane gasoline and jet fuel and increased spot sales in the Ohio Valley market area. Gross margin increased because crude prices decreased more than product prices. Profits at the Alaska Refinery decreased \$1.2 million as increased operating and general and administrative costs more than offset the impact of increased margins. Margins increased \$0.21 per barrel sold (3.4%) primarily because of increased product sales prices.

Retail Petroleum's operating profit decreased \$13.3 million primarily because of increased operating and depreciation expenses. Otherwise, increased merchandise and diesel profits were essentially offset by decreased gasoline profits. Merchandise profits increased \$3.3 million because of increased sales, partially offset by slightly lower margins. Diesel profits increased \$0.9 million as the impact of a 1.7 cent per gallon (23%) increase in diesel margins was largely offset by a 10.7 million gallon (9.5%) decrease in sales volumes. Gasoline profits decreased \$4.7 million as a 2.9 cent per gallon (15.4%) decrease in gasoline margins more than offset the impact of an 8.9 million gallon (4.3%) increase in gasoline sales volumes.

Income from continuing operations was \$105.5 million or \$1.93 per share in the first nine months of 1997 compared to \$87.9 million or \$1.52 per share in the first nine months of 1996. Excluding the impact of the Westpan gain in 1997, the income from the Westpan operations during the first nine months of 1996 and the gain from the Cenex transaction on the first nine months of 1996, income from continuing operations was \$65.6 million or \$1.21 per share in the first nine months of 1997 and \$74.5 million or \$1.29 per share in the first nine months of 1996. Average common shares outstanding for the nine months ended September 30 were 54.7 million in 1997 and 57.7 million in 1996.

CAUTIONARY STATEMENT FOR THE PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

As indicated previously, the Company may have included certain forward-looking statements in this Report and includes this provision pursuant to the "safe harbor" provisions of the Private Securities Reform Act of 1995. Whenever, in this Report, the Company or its management express an expectation or belief as to future results, while made in good faith and with a reasonable basis, there is no assurance that the statement of expectation or belief will be achieved or accomplished. Various risk factors could cause actual results to vary significantly from those expressed in any forward-looking statement. Among those factors which the Company has identified are completion

of construction projects within cost and timing plans, the capacity of constructed assets to function as designed and the availability of financial resources to fund construction projects and other planned capital expenditures.

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Competitors : MAPCO INC

View By Earnings

PETROLEUM REFINING

-  **AMERADA HESS CORP**
-  **AMOCO CO**
-  **AMOCO CORP**
-  **ARABIAN SHIELD DEVELOPMENT CO**
-  **ASHLAND INC**
-  **ATLANTIC RICHFIELD CO /DE**
-  **BP PRUDHOE BAY ROYALTY TRUST**
-  **CASTLE ENERGY CORP**
-  **CHEVRON CORP**
-  **CLARK REFINING & MARKETING INC**
-  **CLARK USA INC /DE/**
-  **CROWN CENTRAL PETROLEUM CORP /MD/**
-  **DIAMOND SHAMROCK INC**
-  **EXXON CORP**
-  **FINA INC**
-  **GIANT INDUSTRIES INC**
-  **HOLLY CORP**
-  **HUNTWAY PARTNERS L P**
-  **LYONDELL PETROCHEMICAL CO**
-  **MAPCO INC**
-  **MOBIL CORP**
-  **MURPHY OIL CORP /DE**
-  **PENNZOIL CO /DE/**
-  **PHILLIPS PETROLEUM CO**
-  **QUAKER STATE CORP**
-  **SHELL OIL CO**

-  [SUN CO INC](#)
-  [TESORO PETROLEUM CORP /NEW/](#)
-  [TEXACO INC](#)
-  [TOSCO CORP](#)
-  [TRANSAMERICAN REFINING CORP](#)
-  [ULTRAMAR DIAMOND SHAMROCK CORP](#)
-  [UNOCAL CORP](#)
-  [USX CORP](#)
-  [VALERO ENERGY CORP](#)
-  [WAINOCO OIL CORP](#)

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CENTRAL INDEX KEY:	0000062142
STANDARD INDUSTRIAL CLASSIFICATION:	PETROLEUM REFINING [2911]
IRS NUMBER:	730705739
STATE OF INCORPORATION:	DE
FISCAL YEAR END:	1231

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SEC FILE NUMBER:	001-05254
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BUSINESS ADDRESS:

STREET 1:	1800 S BALTIMORE AVE
CITY:	TULSA
STATE:	OK
ZIP:	74119
BUSINESS PHONE:	9185993712

MAIL ADDRESS:

STREET 1:	P O BOX 645
CITY:	TULSA
STATE:	OK

ZIP: 74101-0645

FORMER COMPANY:

FORMER CONFORMED NAME: MID AMERICA PIPELINE CO
DATE OF NAME CHANGE: 19710923

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<TYPE>10-K

<SEQUENCE>1

<DESCRIPTION>FORM 10-K FOR YEAR ENDED DECEMBER 31, 1997

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1997

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-5254

MAPCO INC.
(Exact name of registrant as specified in its charter)

<TABLE>

<S>

<C>

DELAWARE
(State or other Jurisdiction of
Incorporation or Organization)

73-0705739
(I.R.S. Employer
Identification No.)

1800 SOUTH BALTIMORE AVENUE, TULSA, OKLAHOMA

74119

(Address of Principal Executive Offices)
</TABLE>

(Zip Code)

Registrant's telephone number, including area code: (918) 581-1800

Securities registered pursuant to Section 12(b) of the Act:

<TABLE>
<CAPTION>

TITLE OF EACH CLASS -----	NAME OF EACH EXCHANGE ON WHICH REGISTERED -----
<S> Common Stock, \$1.00 Par value	<C> New York Stock Exchange Pacific Exchange Chicago Stock Exchange

</TABLE>

Securities registered pursuant to Section 12(g) of the Act: NONE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS. YES ☒ NO ☐

INDICATE BY CHECK MARK IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K (SEC.229.405 OF THIS CHAPTER) IS NOT CONTAINED HEREIN, AND WILL NOT BE CONTAINED, TO THE BEST OF REGISTRANT'S KNOWLEDGE, IN DEFINITIVE PROXY OR INFORMATION STATEMENTS INCORPORATED BY REFERENCE IN PART III OF THIS FORM 10-K OR ANY AMENDMENT TO THIS FORM 10-K. ☐

The aggregate market value of MAPCO Inc.'s ("MAPCO") voting stock held by non-affiliates of MAPCO, based on the last sale price of MAPCO Common Stock on the New York Stock Exchange on February 20, 1998 was \$3,086,148,513.00. On that date, 55,832,614 shares of MAPCO Common Stock were outstanding, of which 54,801,519 shares were held by non-affiliates.

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PART I

ITEM 1. BUSINESS.

BUSINESS OF MAPCO

MAPCO Inc. ("MAPCO" or the "Company") is a diversified energy company which, through separate business units, is engaged in the transportation by pipeline of natural gas liquids ("NGLs"), anhydrous ammonia, crude oil and refined petroleum products; the transportation by truck and rail of NGLs and refined petroleum products; the refining of crude oil; the marketing of NGLs, refined petroleum products and crude oil; the trading of crude oil, refined petroleum products and NGLs; NGL storage; and the marketing of motor fuel and merchandise through convenience store operations. MAPCO was incorporated in Delaware in 1958 and has its principal executive offices in Tulsa, Oklahoma. For convenience of reference and simplification of this report, references herein to MAPCO or the Company include its subsidiaries or affiliates, unless the context requires otherwise.

On November 24, 1997, the Company announced that it had entered into an agreement and plan of merger, as amended as of January 25, 1998 (the "Merger Agreement"), with The Williams Companies, Inc. ("Williams") under which MAPCO will become a wholly-owned subsidiary of Williams (the "Williams Merger"). Under the Merger Agreement, each share of MAPCO common stock and associated preferred stock purchase rights outstanding prior to the Williams Merger will be exchanged for 1.665 shares of Williams common stock and .555 associated preferred stock purchase rights (after giving effect to Williams two-for-one stock split on December 29, 1997) upon consummation of the Williams Merger. The proposed Williams Merger will be completed only if a number of conditions are met or waived, including obtaining (i) the approval of the stockholders of Williams and MAPCO and (ii) receipt of necessary governmental approvals. Consummation of the proposed Williams Merger is expected in the first quarter of 1998. Reference is made to the Joint Proxy Statement/Prospectus of MAPCO and Williams dated January 27, 1998 for a complete description of the Merger Agreement and the transactions contemplated thereby.

In connection with the Williams Merger, also in November 1997, the Company amended its Rights Agreement under which the Company has a one-half Right outstanding for each outstanding share of MAPCO common stock as described in Note 11 to the Consolidated Financial Statements in this Report. This amendment will effectively prevent the Rights from becoming exercisable as a result of the Williams Merger and the consummation of the other transactions contemplated by the Merger Agreement and provides that all outstanding Rights will expire immediately prior to the effective time of the Williams Merger.

CAUTIONARY STATEMENT FOR THE PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Company may have included certain forward-looking statements in this Report and includes this provision pursuant to the "safe harbor" provisions of

the Private Securities Reform Act of 1995. Whenever, in this Report, the Company or its management express an expectation or belief as to future results or future events, while made in good faith and with a reasonable basis based on information currently available to the Company's management, there is no assurance that the statement of expectation or belief will be achieved or accomplished. Various risk factors could cause actual results and events to vary significantly from those expressed in any forward-looking statement.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. The future results and stockholder value of MAPCO may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond MAPCO's ability to control or predict. Stockholders are cautioned not to put undue reliance on any forward-looking statements.

Stockholders of the Company should understand that the following important factors, in addition to those discussed elsewhere in this Report, could affect the future results of the Company, and could cause results to differ materially from those expressed in such forward-looking statements: (i) the effect of economic

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conditions and interest rates on a national, regional or international basis; (ii) the financial resources of, and products available to, competitors; (iii) changes in laws and regulations, including changes in accounting standards; (iv) changes in the securities markets; (v) the timing of the implementation of changes in operations to effect cost savings; (vi) opportunities that may be presented to and pursued by Williams following the Merger; (vii) completion of construction projects within cost and timing plans; and (viii) the capacity of constructed assets to function as designed. In addition, future utilization of pipeline capacity will depend on energy prices, competition from other pipelines and alternate fuels, the general level of natural gas and petroleum product demand and weather conditions, among other things. Further, gas prices which directly impact transportation and gathering and processing throughput and operating profits may fluctuate in unpredictable ways.

BUSINESS UNIT INFORMATION

MAPCO's business is divided into the following business unit reporting structures:

<TABLE>

<CAPTION>

BUSINESS UNIT	BUSINESS ACTIVITY INCLUDED WITHIN BUSINESS UNIT
-----	-----
<S>	<C>
Natural Gas Liquids.....	Liquid Petroleum Gas ("LPG") Distribution, NGL Trading, Pipeline Operations, Fractionation and Underground Storage.

Propane Marketing.....	Wholesale and Retail Marketing of Propane and Appliances.
Petroleum Refining.....	Refining, Wholesale Marketing and Crude and Refined Products Trading.
Retail Petroleum.....	Retail Marketing and Convenience Store Operations.
Other.....	Mobile Information Systems and Bundled Services for Commercial Fleets.

</TABLE>

Financial information about MAPCO's continuing business units for each of the three years in the period ended December 31, 1997 is set forth in Note 14 to the consolidated financial statements on page F-22 and Management's Discussion and Analysis of Financial Condition and Results of Operations on page 16.

NATURAL GAS LIQUIDS

GENERAL

The Natural Gas Liquids business unit operations include the transportation and sale of NGLs as well as pipeline transportation of anhydrous ammonia, refined petroleum products and crude oil. The NGL business unit operations also include fractionation and underground storage systems. The 1997 Natural Gas Liquids revenues were \$750.6 million and operating profit was \$183.6 million compared to \$716.4 million of revenues and \$137.1 million of operating profit in 1996. Operating profit in 1997 includes a \$66.0 million gain on the sale of MAPCO's interest in the West Panhandle field.

NGL PROCESSING AND TRADING

MAPCO owns a 50% interest in and operates a 107,000 barrel per day fractionator at Conway, Kansas. This fractionator receives mixed NGLs from the gathering areas in the Overthrust Belt area of Wyoming and Utah, New Mexico, west Texas, western Oklahoma, Colorado and Kansas for separation into ethane-propane mix, propane, normal butane, iso-butane and natural gasoline. After separation, the products are moved principally to markets in the Midwest and on the Texas Gulf Coast through MAPCO's Mid-America and Seminole pipeline systems.

MAPCO buys, sells and exchanges domestic and imported NGLs in the Midwest, Gulf Coast and Rocky Mountain regions. MAPCO purchases all of its NGLs from outside sources and sales are made under both short and long-term arrangements.

NGL sales and purchases for 1997 averaged 77,947 barrels per day compared with 73,696 barrels per day in 1996. The supply of and demand for NGLs can materially affect the volume of product available to MAPCO and also the market for such product.

MID-AMERICA PIPELINE

Mid-America Pipeline Company ("Mid-America"), a wholly-owned subsidiary of MAPCO Natural Gas Liquids Inc., owns and operates 7,668 miles of pipeline and related pumping, metering and storage facilities. The main system consists of 7,636 miles of pipeline; the remaining 32 miles is the portion of the pipeline which runs from near Collierville, Tennessee to MAPCO's Refinery in Memphis, Tennessee.

The Mid-America pipeline system transports NGLs which consist of the following: propane used as fuel and petrochemical feedstock; butane and natural gasoline used as refinery and petrochemical feedstock; ethane-propane mixtures and ethylene used as petrochemical feedstock; and mixed NGLs for further fractionation. The pipeline system consists of 7,636 miles of pipe varying in diameter from two to twelve inches. The main line of this pipeline system runs from the Wyoming-Utah Overthrust Belt area through the northwestern New Mexico portion of the Four Corners area to near Hobbs, New Mexico, and from Hobbs to Conway, Kansas, where it branches into east and west legs. The west leg extends to near Minneapolis, Minnesota, and the east leg leads to near Janesville, Wisconsin. Spurs from these legs extend into southeast Kansas, Iowa and Illinois.

Mid-America also transports crude oil from St. James, Louisiana to Memphis, Tennessee. This crude oil is transported in pipeline space leased by Mid-America in the Capline Pipeline system which extends from St. James to near Collierville, Tennessee. Crude oil is then transported through a 45-mile pipeline, operated and partially owned (32 miles only) by Mid-America to MAPCO Petroleum's Memphis Refinery. In order to increase throughput of crude to the Company's Memphis Refinery, the pipeline was looped in the Fall of 1996. This process increased the length of the line by 13 miles. Effective January 1, 1996, the Mid-America space on the Capline System was leased by the Petroleum Refining business unit.

SEMINOLE PIPELINE

Seminole Pipeline Company ("Seminole") owns 1,311 miles of pipeline, predominantly fourteen inches in diameter, extending from Hobbs Station in west Texas to the Mont Belvieu Terminal on the Texas Gulf Coast, together with related pumping, metering and storage facilities. MAPCO owns 80% of the stock of Seminole and operates and manages the pipeline.

Seminole operates as a batch system moving demethanized mix, ethane-propane mix and specification liquid products. Products are received from gas processing plants and from Mid-America for delivery to various destinations along the pipeline system. The Texas Gulf Coast market served by Seminole is predominantly for petrochemical and refining feedstock.

See "Legal Proceedings" Item 3 beginning on page 12 for information concerning litigation proceedings connected with Seminole.

MAPCO AMMONIA PIPELINE

MAPCO Ammonia Pipeline (the "Ammonia System") transports liquid anhydrous ammonia for use as fertilizer. This system consists of 1,093 miles of pipeline varying from four to eight inches in diameter. It receives ammonia from plants in the Texas Panhandle and near Enid and Tulsa, Oklahoma for delivery to points principally in Kansas, Nebraska, Iowa and southern Minnesota. The Ammonia System is owned by the Company and is operated by Mid-America.

RIO GRANDE PIPELINE

In November 1995, Juarez Pipeline Company (a wholly-owned subsidiary of Mid-America), Amoco Rio Grande Pipeline Company and Navajo Southern Inc. formed a partnership under the name Rio Grande Pipeline Company ("Rio Grande"). Rio Grande transports NGLs from Mid-America's Hobbs Station in Texas and other Mid-America origins to the Pemex Gas y Petroquimica Basica ("Pemex") Mendez terminal in Ciudad Juarez, Mexico through a 244 mile, 8-inch pipeline. The Mexican customer purchasing the NGLs is PMI Trading Company. The partnership pipeline connects with the Mid-America NGL system through an 8-inch line purchased from Navajo Pipeline Company running from west of Odessa, Texas to near El Paso,

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Texas. Construction of a new 8-inch pipeline connecting the 8-inch Navajo line to the Pemex terminal in Ciudad Juarez and additional facilities at the Pemex terminal to efficiently receive incoming shipments was completed in 1997. Rio Grande is operated by Mid-America (under contract with Rio Grande) and first shipments on the new pipeline system began in March 1997.

DISCOVERY PRODUCER SERVICES

In February 1997, MAPCO Energy L.L.C., a Delaware limited liability company wholly-owned by MAPCO ("MAPCO Energy"), formed a joint venture with Texaco Exploration and Production Inc. ("Texaco") under the names Discovery Producer Services, LLC and Discovery Gas Transmission LLC ("Discovery"), which owns and operates the Discovery Project. Discovery has constructed a 150-mile pipeline varying in diameter from 12 inches to 30 inches to transport natural gas from offshore discovery wells in the Gulf of Mexico to gas processing and fractionation facilities in southern Louisiana. First shipments on the new pipeline began in December 1997. The joint venture is also constructing a cryogenic gas processing plant with a capacity of approximately 600 million cubic feet of gas per day near Larose, Louisiana, and will expand a natural gas liquids fractionator in Paradis, Louisiana. The project's gas processing plant and fractionator are both expected to be fully operational by July 1998. MAPCO

Energy and Texaco each own 50% of the joint venture and a Texaco affiliate is the operator. MAPCO Energy's net investment in the Discovery Project in 1997 was \$59.3 million, which included total expenditures of \$126.7 million, net of \$67.4 million of MAPCO Energy's share of the external financing secured by the joint venture. Its investment in 1998 is expected to be \$19.6 million, which will include total expenditures of \$53.5 million, net of \$33.9 million of MAPCO Energy's share of the joint venture's expected external financing.

ALLIANCE PIPELINE

On April 30, 1997, MAPCO purchased a 5% ownership in the Alliance pipeline project. The Alliance pipeline will construct a 1,900 mile, 36-inch diameter, natural gas pipeline transmission system to carry natural gas and natural gas liquids from western Canada to the Midwest United States for marketing throughout North America. Alliance's delivery points near Chicago include a natural gas liquids extraction facility proposed by Aux Sable Liquids Products LP, which is adjacent to the northern end of MAPCO's 10,000 mile NGL pipeline network. Construction of the pipeline is expected to begin in the second quarter of 1998 with completion anticipated by year-end 1999.

OTHER TRANSPORTATION AND DISTRIBUTION ARRANGEMENTS

On August 1, 1997, MAPCO announced that it had reached an understanding with Enterprise Products Company ("Enterprise") to provide a groundwork for the formation of a joint venture for the development of a natural gas liquids transportation and distribution system. It is anticipated that this system will be capable of distributing product from key NGL sources in southern Louisiana with direct connections to major NGL markets, including the Louisiana river markets, Lake Charles, Louisiana and Mont Belvieu, Texas. The parties executed a Memorandum of Understanding ("MOU") setting forth the principal terms being considered with respect to proposed NGL opportunities. The MOU was scheduled to expire of its own terms on December 31, 1997 but has been extended to March 31, 1998.

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LIQUID MOVEMENTS

The following table summarizes the Mid-America, Ammonia and Seminole Systems' total movements of liquids in millions of barrel miles (barrels of liquids times number of miles transported) and revenue per 100 barrel miles for each of the past five years:

<TABLE>
<CAPTION>

BARREL MILES (IN MILLIONS)
AND REVENUE PER 100 BARREL MILES

	1997	1996	1995	1994	1993
<S>	<C>	<C>	<C>	<C>	<C>
Natural Gas Liquids.....	140,391	133,122	108,476	109,854	95,568
Anhydrous Ammonia.....	3,777	3,610	3,505	3,851	3,587
Crude Oil and Refined Products.....	771	894*	4,787	5,215	4,971
Total.....	144,939	137,626	116,768	118,920	104,126
Revenue Per 100 Barrel Miles.....	18.3c	19.2c	18.8c	18.7c	19.2c

</TABLE>

* Effective January 1, 1996, space previously leased by the NGL business unit on the Capline System was leased by the Petroleum Refining business unit.

The Mid-America, Ammonia and Seminole Systems operate as common carriers. The single largest shipper accounted for 20% of pipeline transportation revenues during 1997. Total pipeline deliveries in 1997 were 289 million barrels, compared with 288 million barrels in 1996.

LIQUIDS SUPPLY

The United States Department of Energy estimates of total proved reserves of NGLs for Mid-America's and Seminole's source of supply areas in Texas, New Mexico, Oklahoma, Kansas, Colorado, Wyoming and Utah are as follows:

<TABLE>

<CAPTION>

TOTAL INDUSTRY RESERVES IN MILLIONS OF BARRELS

<S>	<C>
December 31, 1993.....	4,172
December 31, 1994.....	4,145
December 31, 1995.....	4,207
December 31, 1996.....	4,421
December 31, 1997.....	not available

</TABLE>

Mid-America's and Seminole's supply areas are also served by other pipelines.

NGL PRODUCTION

During 1996, MAPCO Natural Gas Liquids Inc. ("MNGL") owned certain liquefiable hydrocarbons in natural gas in the West Panhandle gas field of Texas. The liquids produced in the field were moved through MNGL's Mid-America and Seminole pipeline systems to Midwestern and Gulf Coast markets. MNGL's West Panhandle field gas supplier had taken more than its percentage ownership share of the field's production. The cumulative effect of this acceleration in gas taken had resulted in the Westpan operations having a 31 billion cubic feet and \$30 million over-take position as of December 31, 1996. MAPCO sold all of its interests in the West Panhandle field to Westpan NGL Co., a subsidiary of Mesa Operating Company ("Mesa") effective January 1, 1997. In connection with the sale, MAPCO was released from liability for its share of prior NGL "over-takes." As part of the transaction, MAPCO has continued to purchase Mesa's liquids produced from the field and will continue to transport the liquids on its Mid-America Pipeline System.

UNDERGROUND STORAGE

Underground storage facilities for NGLs are owned or operated by MAPCO at locations along its pipeline system in the states of Iowa, Kansas, Nebraska, Oklahoma and Texas. The capacity of these facilities

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at December 31, 1997, was approximately 19.3 million barrels. Other storage operations compete with MAPCO for storage leasing in the Conway and Hutchinson, Kansas areas.

COMPETITIVE CONDITIONS

The marketing of NGLs, the underground storage business and the transportation businesses in which MAPCO operates are highly competitive. MAPCO competes with a number of companies engaged in NGL marketing, some of which are larger than MAPCO and may have more significant financial resources. In addition, other pipelines, tank cars, trucks, barges and local sources of supply (refineries, gasoline plants and ammonia plants) and other sources of energy such as natural gas, coal, oil and electricity, all provide competition for pipeline operations.

A portion of the Mid-America System transports propane, which is a seasonal product due to its uses as residential and commercial heating fuel. The Ammonia System is also sensitive to seasonal variations and provides more operating profit to the Company during the spring and summer months when fertilizer use reaches its peak in areas of the country supplied by this system.

REGULATIONS AND ENVIRONMENTAL MATTERS

The Natural Gas Liquids business unit is subject to various federal, state

and local environmental and safety laws and regulations. It is the policy of the Natural Gas Liquids business unit to comply with such laws and regulations. At this time, MAPCO cannot accurately predict the effect which such laws and regulations may have on such activities and future earnings. Pipeline operations are subject to the provisions of the Hazardous Liquid Pipeline Safety Act. In addition, the tariff rates, shipping regulations and other practices of Mid-America and Seminole are regulated by the Federal Energy Regulatory Commission pursuant to the provisions of the Interstate Commerce Act applicable to interstate common carrier petroleum and petroleum products pipelines. The tariff rates and practices of the Ammonia System are regulated by the Surface Transportation Board under the provisions of the Interstate Commerce Commission Termination Act of 1995 applicable to pipeline carriers. Both of these statutes require the filing of reasonable and nondiscriminatory tariff rates and subject MAPCO to certain other regulations concerning its terms and conditions of service.

The United States Department of Transportation has prescribed safety regulations for common carrier pipelines. The pipeline systems are subject to various state laws and regulations concerning safety standards, exercise of eminent domain and similar matters. Mid-America and Seminole also file tariff rates covering intrastate movements with various state commissions.

The Natural Gas Liquids business unit did not incur in 1997 and does not anticipate to incur in 1998 any material capital expenditures for environmental control facilities.

PROPANE MARKETING

The Propane Marketing business unit markets and distributes propane and appliances on the wholesale and retail levels. Propane is used principally as a fuel in various domestic, commercial, industrial, agricultural and vehicle motor fuel applications. Residential customers, who account for the majority of sales, use propane for home heating, cooking and other domestic purposes. The primary agricultural use is crop drying. Commercial and industrial uses include fuel for shopping centers and industrial plants.

Revenues in 1997 for the Propane Marketing business unit were \$413.4 million, compared to \$429.5 million in 1996. Propane Marketing's operating loss in 1997 was \$6.2 million compared to an operating profit of \$65.0 million in 1996, which included a \$20.8 million gain on the sale of propane and fertilizer assets to CENEX, referred to below.

The retail marketing of propane and appliances is carried on under the trade name "Thermogas" through 163 Company-owned and operated retail plants in 18 states in the upper Midwest and the Southeast regions of the United States. Propane is also supplied to dealers operating in the same area, as well as to wholesale outlets and industrial accounts. Wholesale appliances are sold through a distributorship to customers in the

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Midwest. Based upon published industry data, Thermogas is currently the fourth largest retail propane marketer in the United States selling propane to more than 350,000 customers. In 1997, MAPCO sold 297.2 million gallons of retail propane compared to 331.4 million gallons in 1996.

Approximately 60% of the propane sold by MAPCO in 1997 was acquired from outside sources. The largest outside propane supplier accounted for approximately 25% of such outside purchases during 1997. MAPCO's propane supply arrangements are standard for the industry with prices being subject to adjustment in accordance with changes in industry-wide market price levels.

In March 1996, the Propane Marketing business unit sold its Iowa propane and liquid fertilizer assets to CENEX Inc. ("CENEX"). The transaction, which was completed on March 29, 1996, also involved the sale to CENEX of the remaining Thermogas liquid fertilizer assets in Arkansas, Illinois, Indiana, Minnesota, Ohio and Wisconsin. Sales and operating revenues for the assets involved in this transaction were \$24 million and \$69 million in 1996 and 1995, respectively, and operating profit was \$2 million in 1996 and \$7 million in 1995.

Effective January 1, 1997, the Propane Marketing business unit acquired the assets and operations of Gas Supply, Inc., an independent wholesale propane company based in Minneapolis, Minnesota, for approximately \$7 million plus working capital. The acquisition has been used to expand MAPCO's current wholesale propane marketing activities under the name "Gas Supply." In 1997, Gas Supply Inc. marketed approximately 194 million gallons of propane in the Central and Northeastern United States compared to 107 million gallons in 1996. MAPCO also acquired Gas Supply Inc.'s related product sales business, a construction company, a 40,000-barrel storage facility and a rail car and truck terminal in Rosemont, Minnesota.

During 1997, MAPCO acquired 19 propane companies at a cost of approximately \$38.5 million. These companies, with combined sales during 1996 of over 35.8 million gallons of propane and other related products, have market areas in Alabama, Arkansas, Florida, Illinois, Indiana, Minnesota, Missouri, North Carolina, Oklahoma, South Dakota and Wisconsin.

In September 1997, MAPCO launched a new company, Thermogas Energy, LLC, whose purpose is to form joint ventures with rural electric cooperatives and municipal utilities to market and distribute propane. As of December 31, 1997, Thermogas Energy, LLC, had completed joint ventures with two rural cooperatives in the state of Kentucky. Thermogas Energy, LLC is wholly-owned by Thermogas.

COMPETITIVE CONDITIONS

Both the wholesale and retail marketing of propane are highly competitive businesses. Many of the Propane Marketing business unit's competitors are large companies with significant financial resources which may be greater than that of MAPCO. Other energy sources such as natural gas, coal, oil and electricity all compete with propane for home heating, agricultural and commercial applications. Propane competes particularly with natural gas in areas served by natural gas distribution systems. The extension of natural gas service may result in the future loss of existing customers.

The retail propane business is largely seasonal due to its primary uses for home heating and crop drying. Accordingly, sales and operating profits are concentrated in the fall and winter months. The Propane Marketing business unit enjoys certain competitive advantages in its marketing areas due to name recognition and by offering a wide array of competitive products and services.

REGULATIONS AND ENVIRONMENTAL MATTERS

The Propane Marketing business is not highly regulated or environmentally sensitive; however, it is the policy of the Propane Marketing business unit to comply with such laws and regulations as applicable. The Propane Marketing business unit did not incur in 1997 and does not anticipate to incur in 1998 any material capital expenditures for environmental control facilities.

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PETROLEUM REFINING

GENERAL

The Petroleum Refining business unit operates two refining and marketing systems: the Alaska System and the Mid-South System. The Alaska System includes a Company-owned refinery which is situated on land leased from the state of Alaska at North Pole, Alaska, a terminal facility at Anchorage, Alaska, which is situated on land leased from the Alaska Railroad Corporation under two long-term leases, and the wholesale marketing of refined petroleum products. The Mid-South System includes a Company-owned refinery at Memphis, Tennessee and the wholesale and spot marketing of refined petroleum products.

The 1997 Petroleum Refining business unit revenues were \$2,308.4 million and operating profit was \$96.8 million compared to \$1,813.4 million of revenues and \$63.9 million of operating profit in 1996.

ALASKA SYSTEM

MAPCO's refinery, located near Fairbanks at North Pole, Alaska (the "North Pole Refinery"), is the largest refinery in the state. The refinery is owned by MAPCO but is situated on land leased by MAPCO from the state of Alaska under a

long-term lease which is not scheduled to expire until 2025 and is renewable by the Company at that time. The refinery is located approximately two miles from its supply point for crude oil, the Trans-Alaska Pipeline System ("TAPS"). The North Pole Refinery's processing capability is approximately 136,000 barrels per day. At maximum crude throughput, 46,000 barrels per day of refined product can be produced. These products are jet fuel, gasoline, diesel fuel, heating oil, fuel oil, naphtha and asphalt. MAPCO markets more than 44,600 barrels per day of these refined products to Alaska, Western Canada and the Pacific Rim. MAPCO's principal market for these products in Alaska is to wholesale, commercial, industrial and governmental customers and to MAPCO's Retail Petroleum business unit operations. MAPCO's Retail Petroleum business unit operations, as described below, accounted for about 10% of the North Pole Refinery's 1997 product sales volume and 76% of the Refinery's gasoline production. In 1997, average throughput at the North Pole Refinery was 132,238 barrels per day of crude oil which resulted in the average production of 44,524 barrels per day of petroleum products compared to 132,912 barrels per day of average crude throughput and average production of 45,599 barrels per day of petroleum products in 1996. MAPCO is in the process of constructing a third crude unit at the North Pole Refinery that will produce an additional 17,000 barrels per day of refined products, including 14,000 barrels per day of jet fuel. The project is expected to be completed in the fourth quarter of 1998 at an estimated cost of \$70 million.

The North Pole Refinery's crude oil is purchased from the state of Alaska or is purchased or received on exchanges from crude oil producers. The North Pole Refinery has an agreement with the state of Alaska for the purchase of royalty oil which is scheduled to expire on December 31, 2003. The agreement provides for the purchase of up to 35,000 barrels per day (approximately 27% of the North Pole Refinery's supply) of the State's royalty share of crude oil produced from Prudhoe Bay, Alaska. These volumes, along with crude oil either purchased from crude oil producers or received under exchange agreements, are utilized as throughput in the production of products at the Refinery. Approximately 34% of the throughput is refined and sold as finished product and the remainder of the throughput is returned to the TAPS and either delivered to repay exchange obligations or sold.

MID-SOUTH SYSTEM

MAPCO's refinery in Memphis, Tennessee ("Memphis Refinery") is the only refinery in the state of Tennessee and has a throughput capacity of approximately 120,000 barrels per day. In 1997, the Memphis Refinery processed an average 110,855 barrels per day compared to 100,730 barrels per day in 1996. On July 22, 1997, MAPCO announced plans to construct a splitter at the Mid-South Refinery that will increase the refinery's capacity for propylene production from the current 2,000 barrels per day to 6,000 barrels per day of the high margin product. The refinery started production on January 19, 1998, of an incremental 2,000 barrels per day of refinery grade propylene and expects to increase production by another 2,000 barrels per day by the end of 1998.

Expenditures for this project are expected to be approximately \$20 million.

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Products produced by the Memphis Refinery are gasoline, low sulfur diesel fuel, jet fuel, K-1 kerosene, propylene, No. 6 fuel oil, propane and elemental sulfur. These products are exchanged or marketed primarily in the Mid-South region of the United States to wholesale customers, such as industrial, governmental and commercial consumers, jobbers, independent dealers, other refiner/marketers and to MAPCO's Retail Petroleum business unit. Sales to MAPCO's Retail Petroleum business unit operations accounted for about 12% of the Memphis Refinery's 1997 sales volume; the largest single customer accounted for approximately 17% of total sales. During 1997, the Memphis Refinery's gasoline sales to MAPCO's Retail Petroleum business unit were 10% of the Refinery's gasoline production.

The Memphis Refinery has access to crude oil from the Gulf Coast via common carrier pipeline and by river barges. In addition to domestic crude oil, the Memphis Refinery has the capability of receiving and processing certain foreign crudes. During 1997, the majority of the crude oil processed at the Memphis Refinery was purchased from various suppliers on a posted-plus price basis. Although this method of purchase reduces the financial effect of volatile crude oil markets, the financial results of the Refinery may be significantly impacted by changes in the market prices for crude oil and refined products. MAPCO cannot with any assurance predict the future of crude oil and product prices or their impact on the financial results of the Petroleum Refining business unit.

CRUDE OIL TRADING

MAPCO buys, sells and exchanges domestic and foreign crude oil to supply its refinery systems in Tennessee and Alaska. MAPCO purchased and sold an average of 93,676 barrels per day of refined petroleum products in 1997 compared to 35,208 barrels per day in 1996.

In July 1997, MAPCO acquired a 100% ownership interest in Lexus Oil, L.L.C. ("Lexus") which had been an unconsolidated 50%-owned entity since 1995. Lexus's principal operations include the trading of petroleum and petroleum-related products.

COMPETITIVE CONDITIONS

The petroleum industry is highly competitive in all phases from the procurement of crude oil to the refining, distribution and marketing of refined products. Many of MAPCO's competitors are large integrated oil companies, which, because of their diverse operations, strong capitalization and recognized brand names may be better able to withstand volatile industry conditions, shortages of crude oil or intense price competition.

The principal competitive forces affecting MAPCO's refining businesses are feedstock costs, refinery efficiency, refinery product mix, product distribution and marketing costs. Some of the Mid-South System's competitors in the refining business can more easily process sour crudes, and accordingly, are more flexible in the crudes which may be processed. Since MAPCO has no crude oil reserves and does not engage in crude oil exploration, it must obtain its crude oil requirements from unaffiliated sources. MAPCO believes that it will be able to obtain adequate crude oil and other feedstocks at generally competitive prices for the foreseeable future.

The Company is currently in the process of reviewing various alternatives for further increasing the flexibility of crude oil which may be processed at the Memphis Refinery as well as opportunities which the Company believes may improve its margins.

REGULATIONS AND ENVIRONMENTAL MATTERS

MAPCO's Petroleum refining business unit is subject to various federal, state and local pricing and environmental laws and regulations. It is the policy of the Petroleum Refining business unit to comply with such laws and regulations. MAPCO's refining operations are subject to regulations relating to air emissions, water discharges, waste generation, transportation, storage and disposal as well as soil and groundwater contamination which may result from spillage or discharge of petroleum and hazardous materials at its

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refineries and terminals. Groundwater monitoring and remediation are ongoing at both refineries and air and water pollution control equipment is operating at both refineries to comply with applicable regulations.

The Clean Air Act Amendments of 1990 (the "CAAA") continue to impact the Petroleum Refining business unit through a number of programs and provisions of the CAAA. The provisions include Maximum Achievable Control Technology rules which are being developed for the refining industry, controls on individual chemical substances and new operating permit rules. The provisions impact other companies in the industry in similar ways and are not expected to adversely impact the Company's competitive position.

The Petroleum Refining business unit incurred approximately \$3.0 million in capital expenditures for environmental control facilities in 1997 and has budgeted \$6.0 million in capital expenditures for environmental control facilities in 1998. Such expenditures are not deemed by the business unit to be material.

See "Legal Proceedings," Item 3 beginning on page 12 for information

concerning environmental proceedings connected with the Petroleum Refining business unit.

RETAIL PETROLEUM

MAPCO, primarily under the brand name "MAPCO Express," is engaged in the retail marketing of gasoline, diesel fuel, other petroleum products, convenience merchandise, restaurants and deli fast food items at 207 stores and interstate travel centers in eight Southeastern states and in Texas and at 25 stores in Anchorage, Fairbanks and southeastern Alaska. MAPCO Express stores represent 38 percent of the convenience store market in Alaska. Effective May 21, 1997, MAPCO acquired 19 retail convenience stores located primarily in the Nashville, Tennessee market from EZ-Serve Inc. at a cost of \$12 million. The Company has also announced a retail expansion program which will add 25 new MAPCO Express stores and travel centers in 1998. All of the motor fuel sold by MAPCO Express stores is supplied either by exchanges or directly from either the Memphis or North Pole Refineries.

Revenues in 1997 for the Retail Petroleum business unit were \$733.2 million, compared to \$714.9 million in 1996. Operating profit in 1997 was \$11.8 million, compared to \$30.3 million in 1996.

MAPCO's stores have been designed to be modern neighborhood-type facilities, attracting convenience-oriented customers with a variety of today's most widely-used products and services. Convenience merchandise and deli fast food accounted for approximately 55% of Retail Petroleum's gross margins in 1997 and 51% in 1996. The Company owns approximately one-half of the properties upon which its stores are located and leases the remainder from third parties.

COMPETITIVE CONDITIONS

The principal competitive factors affecting MAPCO's retail businesses are location, product price and quality, appearance and cleanliness of stores and brand-name identification. Competition in the convenience store industry is intense.

In targeted markets such as Memphis and Nashville, Tennessee and Anchorage, Alaska, the Company is the market leader and enjoys brand-name recognition. The Retail Petroleum business unit was named 1996 convenience store chain of the year by Convenience Store Decision magazine. The award is presented annually to a retailer that best exemplifies excellence throughout its organization. The categories which are considered in determining the recipient of the award are as follows: customer service, product quality, marketing and merchandise innovation, operating efficiency, management effectiveness, imaginative development of the convenience store concept, public service, profitability and growth.

REGULATIONS AND ENVIRONMENTAL MATTERS

MAPCO's Retail Petroleum business unit is subject to various federal, state and local environmental laws and regulations. It is the policy of MAPCO's Retail Petroleum business unit to comply with such laws and regulations. MAPCO's retail petroleum operations are subject to regulations relating to air emissions, water discharge, waste generation, transportation, storage and disposal, as well as soil and groundwater contamination-

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tion which may result from spillage or discharge of petroleum and hazardous materials at its retail outlets. Groundwater monitoring and remediation are ongoing at various MAPCO retail outlets to comply with applicable regulations.

MAPCO's Retail Petroleum business unit is also subject to federal, state and local regulations regarding petroleum underground storage tanks ("USTs"). The United States Environmental Protection Agency ("EPA") and several states in which MAPCO conducts retail operations have adopted laws requiring owners and operators of USTs used for petroleum products to register such tanks with state offices. In addition, these UST regulations have imposed new technical standards, corrective action and financial responsibility requirements relating to such tanks. The regulations establish requirements for owners and operators of USTs, including leak detection systems, corrosion protection systems, tank system repairs and replacement, tank closure and corrective action for leaking tanks. EPA regulations were issued in late 1988, with compliance being phased in over the course of a ten (10) year period.

The Retail Petroleum business unit incurred approximately \$3.6 million in capital expenditures for environmental control facilities in 1997 and has budgeted \$4.8 million in capital expenditures for environmental control facilities in 1998. Such expenditures are not deemed by the business unit to be material.

OTHER BUSINESSES

In February 1997, the Company announced the formation of two new businesses, TouchStar Technologies, L.L.C. ("TouchStar") and FleetOne, L.L.C. ("FleetOne"), designed to expand the Company's marketing efforts into mobile information management systems and bundled services for commercial fleets. Other business revenues and operating loss in 1997 were \$24.6 million and \$8.9 million, respectively. TouchStar specializes in providing information management and combines product measurement, data gathering and dispensing technology with computer hardware and customized software for a total information management solution. TouchStar offers information management systems to track operations and control inventories of energy and other products to improve distribution efficiency and customer service through the use of a mobile, hand-held computer system. In April 1997, TouchStar acquired ACS Data, Ltd., a British company that designs and manufactures hand-held computers and peripherals. In September 1997,

TouchStar opened an office in Celaya, Guanajuato, Mexico which markets liquefied petroleum gas technology equipment, under the name of Espagas, S.A. de C.V. FleetOne combines MAPCO's Retail Petroleum and Propane Marketing fleet fueling activities to provide fleet operators with motor fuel, data management and service alternatives to more effectively manage their businesses.

OTHER MATTERS

On September 10, 1996, the Company completed the disposition of the stock of its former subsidiary companies, MAPCO Coal Inc. and MC Mining Inc. and their respective subsidiaries (the "Coal segment") to Alliance Coal Corporation, a corporation formed by the Beacon Group Energy Investment Fund, L.P., a Delaware limited partnership, and related entities. The assets sold through the stock sale include one surface and six underground mining complexes located in Illinois, Kentucky, Maryland and Virginia, as well as a coal terminal on the Ohio River near Mt. Vernon, Indiana used for the transloading of coal. In connection with the sale, the Company made certain guarantees, indemnifications and representations, and retained certain liabilities; however, management does not expect these items to have a material impact on future results of operations, financial position or cash flows of the Company.

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EMPLOYEES

As of December 31, 1997, MAPCO and its business units had 6,508 employees. Of the total number of employees, 500 were employed in the Natural Gas Liquids business unit; 2,022 in the Propane Marketing business unit; 2,889 in the Retail Petroleum business unit; 555 in the Petroleum Refining business unit; 138 in the TouchStar Technologies and FleetOne businesses; and 404 in the general corporate area. Less than three percent of MAPCO's work force is unionized and covered by collective bargaining agreements. Agreements have been entered into with the Oil Chemical and Atomic Workers Union covering 183 employees in the Petroleum Refining business unit.

ITEM 2. PROPERTIES.

All the various physical properties are discussed in PART I, Item 1, Supra, pertaining to MAPCO's business.

ITEM 3. LEGAL PROCEEDINGS.

Texas Explosion Litigation

On April 7, 1992, a liquefied petroleum gas explosion occurred near an underground salt dome storage facility located near Brenham, Texas and owned by an affiliate of the Company, Seminole Pipeline Company ("Seminole"). The

Company, as well as Seminole, Mid-America Pipeline Company, MAPCO Natural Gas Liquids Inc., and other non-MAPCO entities were named as defendants in civil action lawsuits filed in state district courts located in four Texas counties. Seminole and the related MAPCO entities have settled in excess of 1,600 claims in these lawsuits. The only lawsuit remaining is the Dallmeyer case which was tried before a jury in Harris County. In Dallmeyer, the judgment rendered in March 1996 against defendants Seminole and MAPCO-related entities totaled approximately \$72 million which included nearly \$65 million of punitive damages awarded to the 21 plaintiffs.

Both plaintiffs and defendants have appealed the Dallmeyer judgment to the Court of Appeals for the Fourteenth District of Texas in Harris County. The defendants seek to have the judgment modified in many respects, including the elimination of punitive damages as well as a portion of the actual damages awarded. If the defendants prevail on appeal, it will result in an award significantly less than the judgment, or alternatively, a retrial of the case. The plaintiffs have cross appealed and seek to modify the judgment to increase the total award plus interest to exceed \$155 million. In February and March 1998, the Company entered into settlement agreements involving 12 of the 21 plaintiffs to finally resolve their claims against all defendants for an aggregate payment of \$8 million. These settlements have satisfied and reduced the judgment on appeal by approximately \$33 million.

Management believes that it has defenses of considerable merit and will vigorously litigate the Dallmeyer appeal or seek a satisfactory settlement to the Company, but is not able to predict the ultimate outcome of this matter at this time. The Company has accrued a liability representing an estimate of amounts it may incur to finally resolve all litigation and has also recorded a receivable which corresponds to the remainder of its insurance coverage to be reimbursed by its insurance carrier. Management is unable to estimate a range of loss beyond the amount accrued. Resolutions unfavorable to the Company could result in liabilities and charges materially in excess of the amount accrued.

ENVIRONMENTAL

Memphis Refinery

In 1993, the Environmental Protection Agency ("EPA"), Region IV, conducted an inspection of MAPCO Petroleum Inc.'s ("MPI") Memphis Refinery to evaluate the refinery's compliance status under the New Source Performance Standards ("NSPS") promulgated under Section 111 of 42 U.S.C. sec. 7411. Following the inspection, the EPA issued a Notice of Violation to MPI dated May 5, 1994. This notice requested that MPI respond with requested information relevant to various alleged Clean Air Act violations. MPI furnished the requested information and, during 1995 and 1996 negotiations between MPI and the EPA

resulted in a final settlement under which MPI paid the EPA a penalty of \$95,000, and, in 1997, MPI completed three Supplemental Environmental Projects. The Consent Decree was signed by the judge on March 28, 1997, and entered by the court on March 31, 1997.

North Pole Refinery

During 1993, the EPA, Region X conducted a multimedia inspection at MAPCO Alaska Petroleum Inc.'s ("MAPI") North Pole Refinery located near Fairbanks, Alaska. Following the inspection, the EPA issued two Information Requests relating to New Source Performance Standards ("NSPS"). In 1995, the U.S. Department of Justice, Environmental and Natural Resources Division also served written notice upon MAPI of civil claims under the NSPS of the Clean Air Act. The Department of Justice offered to defer litigation if MAPI would enter into settlement negotiations.

After over a year of settlement discussions, MAPI reached agreement with the Department of Justice and the EPA, Region X. Under the terms of the Consent Decree, MAPI paid a penalty of \$425,000 in December 1996, and performed two Supplemental Environmental Projects having a total cost of approximately \$397,000 in 1997.

SEC TRADING INVESTIGATION

After the announcement of the proposed merger with The Williams Companies Inc., the Company received inquiries from the Securities and Exchange Commission and the New York Stock Exchange concerning pre-announcement trading in the Company's securities. The Company is cooperating with the investigations. It has made partial responses to the inquiries, including information concerning transfers by certain Company employees into a fund invested exclusively in MAPCO stock which is part of the Company's 401(k) plan for salaried employees.

GENERAL

The Company and its business units are involved in various other lawsuits, claims and regulatory proceedings incidental to their businesses. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's business, consolidated financial position, results of operations or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the fourth quarter of 1997.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Information regarding the market for MAPCO's common equity and related stockholder matters is set forth herein at page 31.

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ITEM 6. SELECTED FINANCIAL DATA.

The following table contains selected financial data for the years indicated, restated to reflect discontinued operations and a two-for-one stock split effected in the form of a stock dividend from shares held as treasury stock, both occurring in 1996 (in millions, except per share data):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,				
	1997 (A)	1996	1995	1994 (G)	1993
	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
INCOME STATEMENT DATA:					
Sales and Operating Revenues.....	\$3,847.5	\$3,353.1	\$2,856.6	\$2,663.8	\$2,300.9
Income from Continuing Operations.....	\$ 104.5 (C)	\$ 130.2 (D)	\$ 64.2 (E)	\$ 50.2 (F)	\$ 91.8
Income (Loss) from Discontinued Operations(B).....	\$ (6.3)	\$ (32.7)	\$ 10.5	\$ 28.9	\$ 35.2
Cumulative Effect of Change in Accounting Principle.....	\$ (1.3)	--	--	--	--
Net Income.....	\$ 96.9	\$ 97.5	\$ 74.7	\$ 79.1	\$ 127.0
PER SHARE DATA: (H)					
Basic Earnings per Common Share:					
Income from continuing operations.....	\$ 1.91	\$ 2.27	\$ 1.08	\$.84	\$ 1.53
Income (loss) from discontinued operations.....	\$ (.12)	\$ (.57)	\$.18	\$.48	\$.59
Cumulative effect of change in accounting principle.....	\$ (.02)	--	--	--	--
Net income.....	\$ 1.77	\$ 1.70	\$ 1.26	\$ 1.32	\$ 2.12
Diluted Earnings per Common Share:					
Income from continuing operations.....	\$ 1.88	\$ 2.26	\$ 1.08	\$.83	\$ 1.52
Income (loss) from discontinued operations.....	\$ (.12)	\$ (.57)	\$.17	\$.48	\$.58
Cumulative effect of change in accounting principle.....	\$ (.02)	--	--	--	--
Net income.....	\$ 1.74	\$ 1.69	\$ 1.25	\$ 1.31	\$ 2.10
Pro Forma amounts assuming retroactive application of accounting change:					
Income from continuing operations.....	\$ 103.8	\$ 129.6	\$ 64.2	\$ 50.2	\$ 91.8

Net Income.....	\$ 97.5	\$ 96.9	\$ 74.7	\$ 79.1	\$ 127.0
Cash Dividends Declared per Common Share.....	\$ 0.60	\$ 0.525	\$ 0.50	\$ 0.50	\$ 0.50
BALANCE SHEET DATA: (J) (K)					
Property, plant and equipment -- net.....	\$1,481.2	\$1,356.9	\$1,312.0	\$1,200.6	\$1,092.6
Total Assets.....	\$2,407.7	\$2,170.7	\$2,282.7	\$2,115.6	\$1,912.8
Long-term Debt (excluding current maturities).....	\$ 786.2	\$ 608.4	\$ 801.0	\$ 720.9	\$ 585.5
Stockholders' Equity.....	\$ 670.7(I)	\$ 603.6(I)	\$ 642.3	\$ 622.6	\$ 574.3
RATIO OF EARNINGS TO FIXED CHARGES(L).....	3.7	4.4	2.6	2.4	3.8

</TABLE>

-
- (A) On November 24, 1997, MAPCO Inc. and The Williams Companies, Inc. ("Williams") announced that they had entered into a definitive merger agreement, as amended as of January 25, 1998, in which MAPCO will become a wholly-owned subsidiary of Williams in a non-taxable, stock-for-stock transaction which is expected to be accounted for as a pooling of interest under Accounting Principles Board Opinion No. 16. See Note 2 of the Notes to Consolidated Financial Statements for additional information.
- (B) In June 1996, the Company concluded that it would sell substantially all of its Coal business to Alliance Coal Corporation ("Alliance"), a corporation formed by Beacon Group Energy Investment Fund L.P. and related entities. The transaction was completed on September 10, 1996, with an effective date of July 31, 1996. The selected historical consolidated financial data have been prepared to present operating results of the operations sold to

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Alliance as discontinued operations. For additional information, see Note 3 of the Notes to Consolidated Financial Statements.

- (C) Effective January 1, 1997, MAPCO sold its interest in the natural gas liquids and condensate in the West Panhandle field to Westpan NGL Company, a subsidiary of MESA Operating Company, for \$66.0 million. The Company recognized a gain of \$66.0 million on the transaction in the first quarter of 1997 as MAPCO had no book value in the interest sold. Income from continuing operations included \$39.5 million from this transaction. See Note 4 of Notes to Consolidated Financial Statements for additional information.
- (D) In January 1996, the Company signed an agreement to sell its Thermogas Iowa propane and liquid fertilizer assets as well as its remaining liquid fertilizer assets in Arkansas, Illinois, Indiana, Minnesota, Ohio and Wisconsin to CENEX, Inc. ("CENEX"). The sale of assets to CENEX was

completed on March 29, 1996. Income from continuing operations included \$12.8 million (\$20.8 million pre-tax) from this transaction. See Note 4 of Notes to Consolidated Financial Statements for additional information.

- (E) Income from continuing operations in 1995 includes a charge for severance and early retirements associated with reorganizations of \$6.5 million (\$10.3 million pre-tax). See Note 13 of Notes to Consolidated Financial Statements for additional information.
- (F) Income from continuing operations in 1994 includes a charge of \$44.0 million (\$68.7 million pre-tax) related to the settlement of a long-standing dispute with the State of Alaska relative to its royalty oil purchase agreements.
- (G) On September 1, 1994, MAPCO completed the acquisition of certain assets of Emro Propane Company. The purchase price included a \$186 million cash payment and the transfer to Emro Marketing Company of the retail convenience store assets of MAPCO Florida Inc.
- (H) On September 30, 1996, a two-for-one stock split effected in the form of a stock dividend from shares held as treasury stock was distributed. Earnings Per Common Share and Cash Dividends Declared per Common Share have been restated for the effect of the stock split. Actual Cash Dividends declared per share were \$1.00 in years 1993 through 1995. In 1997, MAPCO adopted FAS 128 which changed the presentation of per share amounts from prior years. All per share amounts have been restated for the effect of this change.
- (I) In the fourth quarter of 1996, equity put options that entitle the holder, upon exercise, to sell shares of Common Stock to the Company at a specified price, were sold in a series of private placements. At December 31, 1997 and 1996, Stockholders' Equity was reduced by \$12.3 million and \$16.7 million, respectively, as a result of the unexpired equity put options. All of the outstanding options at December 31, 1997, expired out-of-the-money during January and February 1998. The Company does not expect to issue any further equity put options.
- (J) The Company, and three of its subsidiaries, have been named as defendants in civil action lawsuits in four Texas counties. The suits are associated with a liquefied petroleum gas explosion that occurred on April 7, 1992. See Note 16 of Notes to Consolidated Financial Statements for additional information.
- (K) During 1997, 1996, 1995, 1994 and 1993, MAPCO purchased a total of 1,589,354; 2,578,212; 1,163,200; 296,932; and 203,898 shares, respectively, of its common stock on the open market at a cost of \$50.2 million, \$98.3 million, \$31.1 million, \$8.7 million, and \$6.2 million, respectively. On September 30, 1996, 28,674,812 treasury shares were distributed to stockholders in the form of a two-for-one stock dividend. (All share

amounts have been restated to reflect this stock dividend). In the third quarter of 1996, the Board of Directors approved a 7.0 million share stock repurchase plan, representing 12% of the post-split common stock outstanding. As of December 31, 1997, 3,789,606 shares had been purchased under this authorization for \$117.9 million and there were 8,405,267 shares of common stock in the treasury. In November 1997, in connection with the announcement of the Company's planned merger with The Williams Company, MAPCO suspended further purchases of treasury stock.

- (L) For purposes of the ratio of earnings to fixed charges amounts, (i) earnings consist of income from continuing operations before fixed charges, minority interest expense and income taxes for MAPCO and its majority-owned subsidiaries; and (ii) fixed charges consist of interest and debt expense on all indebtedness (without reduction of interest capitalized) and that portion of rental payments on operating leases estimated to represent an interest factor.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management's Discussion and Analysis may contain forward-looking statements, including, without limitation, statements relating to the Company's plans, strategies, objectives and expectations and are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Any such forward-looking statements involve known and unknown risks and uncertainties and the Company's actual results may differ materially from those forward-looking statements. The Company does not undertake to update, revise or correct any of the forward-looking information contained in this document. Readers are cautioned that such forward-looking statements should be read in connection with the Company's disclosures under the heading "CAUTIONARY STATEMENT FOR THE PURPOSES OF THE 'SAFE HARBOR' PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" on page 1.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of MAPCO Inc.'s ("MAPCO" or the "Company") financial condition, results of operations and cash flow should be read in conjunction with the financial statements and segment information presented on pages through of this report.

FINANCIAL CONDITION

CASH GENERATION (USAGE)

Cash generation (usage) was as follows (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----	-----	-----
<S>	<C>	<C>	<C>
Net cash provided by continuing operations.....	\$ 69	\$ 241	\$ 167
Net cash provided by discontinued operations.....	--	22	63
	-----	-----	-----
Net cash provided by operating activities.....	69	263	230
Net cash provided by (used in) investing activities.....	(240)	114	(244)
Net cash provided by (used in) financing activities.....	107	(305)	17
	-----	-----	-----
Cash generation (usage).....	\$ (64)	\$ 72	\$ 3
	=====	=====	=====

</TABLE>

The decrease in cash provided by continuing operations in 1997 was primarily due to reduced operating profit, increased working capital requirements and the payment of \$33 million for non-compete agreements entered into with executive officers. The increase in funds provided by continuing operations in 1996 was primarily attributable to increased income by all of MAPCO's business units.

The decrease in cash provided by discontinued operations in 1996 primarily reflects lower income by the Coal operations due to the sale of those operations at the end of July 1996.

Capital expenditures and acquisitions in 1997 were \$238 million, of which \$69 million were for capital items necessary to maintain existing operations. Significant capital expenditures and acquisitions in 1997 included: \$39 million for the acquisition (which includes the exchange of \$18 million of MAPCO common stock plus \$21 million in cash) of various propane marketing businesses, \$12 million for the acquisition of 19 convenience stores from EZ-Serve Inc., \$11 million for the acquisition of ACS Data LTD., \$7 million for the acquisition of the assets of Gas Supply Inc., \$28 million to build or remodel convenience stores and travel centers, \$21 million for the addition of a propylene splitter, expansion of the alkalization unit, replacement of the fluid catalytic cracker blower and an additional storage tank at the Mid-South Refinery, \$17 million to build new plants and implement a new computer system in the Propane Marketing business unit and \$6 million for the new gasoline and jet fuel expansion projects at the Alaska Refinery. The proceeds from net assets held for sale includes the \$66.0 million received from the sale of MAPCO's interests in the West Panhandle field. Expenditures in 1997 for investments in unconsolidated affiliates were \$71 million, which

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included \$59 million for Discovery (net of \$68 million of MAPCO's portion of Discovery's financing proceeds), \$5 million for the Alliance Pipeline investment and \$6 million for the Rio Grande Pipeline venture.

Capital expenditures and acquisitions in 1996 were \$157 million, of which \$50 million were for capital items necessary to maintain continuing operations. Included in the \$157 million was \$22 million for capital expenditures for the discontinued coal operations. Capital expenditures in 1996 also included \$12 million for a saturated gas plant expansion at the Memphis Refinery, \$9 million for a gasoline expansion project at the North Pole Refinery, \$6 million for the acquisition of a propane company in Colorado, \$5 million for expansion of the Memphis crude line, \$4 million for the expansion of the Hobbs Station in west Texas and \$4 million for environmental projects. MAPCO also expended \$23 million in 1996 for its investment in the Rio Grande Pipeline joint venture. Cash from investing activities in 1996 included \$236 million received from the sale of the Coal segment to Alliance Coal Corporation, a corporation formed by The Beacon Group Energy Investment Fund L.P. ("Beacon") and \$43 million from the sale of Thermogas Company's Iowa propane and liquid fertilizer assets to CENEX Inc. ("CENEX").

Capital expenditures and acquisitions in 1995 were \$251 million, of which \$50 million was for capital items necessary to maintain continuing operations. Capital expenditures in 1995 included \$82 million for the expansion of the Rocky Mountain Pipeline System, \$30 million for capital improvements at the Memphis Refinery, \$11 million for the acquisition of 27 retail gasoline/convenience stores in the Nashville, Tennessee, market area, \$33 million for the discontinued Coal operations and \$16 million for environmental projects.

Cash from financing activities in 1997 included the use of \$50 million in cash to purchase 1.6 million shares of treasury stock, \$33 million to pay cash dividends and \$30 million in payments on long-term debt. In the first quarter of 1997, MAPCO issued \$100 million of senior subordinated notes with a coupon rate of 7.25% that are due in 2009 and \$100 million of senior subordinated debentures with a coupon rate of 7.70% that are due in 2027.

Cash from financing activities in 1996 included the use of \$161 million in cash to reduce variable-rate borrowings, \$98 million to purchase 2.6 million shares of treasury stock, \$30 million for cash dividends and \$21 million to reduce long-term debt. Part of the proceeds from the sale of the Coal segment were used to pay down debt.

Cash from financing activities in 1995 included \$105 million of borrowings of variable-rate debt, \$31 million to purchase treasury stock, \$30 million for cash dividends and \$27 million to reduce long-term debt.

Various loan agreements contain restrictive covenants which, among other things, limit the payment of advances or dividends by two of Natural Gas Liquids' ("NGL") subsidiaries to MAPCO. At December 31, 1997, \$250 million of net assets were restricted by such provisions, which included \$60 million of restricted net assets associated with the Discovery joint venture. At December 31, 1996, \$190 million of net assets were restricted by such provisions.

LIQUIDITY AND CAPITAL RESOURCES

MAPCO's primary sources of liquidity are its cash and cash equivalents, internal cash generation, and external financing, including its long-term leasing arrangement. At December 31, 1997, MAPCO's cash and cash equivalents were \$41 million compared to \$105 million at December 31, 1996.

MAPCO's external financing sources include its bank credit agreements, its uncommitted bank credit lines, its ability to issue public or private debt, including commercial paper, and its leasing arrangement. MAPCO's bank credit agreements represent a total committed line of credit of \$400 million which expires in March 2002. The bank credit agreement serves as a back-up for outstanding commercial paper and for borrowings against bank money market lines. As of December 31, 1997 and 1996, no borrowings were outstanding under the bank credit agreement.

In 1996, the Company entered into a long-term lease arrangement to accommodate the acquisition and construction of certain assets. Leases, which will be entered into under the master lease arrangement, will be

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for seven year terms. Rent payable under the lease is based on the amounts spent for acquisition or construction of assets and the lessor's cost of funds. After the non-cancelable lease term, the arrangement may be extended by agreement of the parties, or the Company may purchase or arrange for the sale of the assets. As of December 31, 1997, all of the \$100 million commitment remained available under the lease.

In 1990, MAPCO filed a shelf registration statement with the Securities and Exchange Commission ("SEC") providing for the issuance of up to \$400 million of debt securities. As of December 31, 1997, MAPCO had outstanding \$264 million of Medium Term Notes issued pursuant to this registration. The remaining amount of debt securities authorized under this registration was deregistered during 1997. On January 31, 1997, MAPCO filed a shelf registration with the SEC providing for the issuance of up to \$500 million of debt and equity securities. The Company issued \$200 million of medium and long-term notes under that registration during the first quarter of 1997. The proceeds from that debt issuance were used for general corporate purposes, including working capital, capital expenditures,

reduction of other debt and acquisitions.

The Company was a party to various interest rate swap agreements with financial institutions which effectively changed the Company's interest rate exposure from variable rates to fixed rates on \$100 million of debt. In the first quarter of 1997, the Company recognized a \$4.3 million gain upon termination of the interest rate swap agreements, which was done concurrently with the pay-off of the related debt.

In the third quarter of 1996, the Company announced a four-point plan approved by the Board of Directors, which included the repurchase of up to 7.0 million shares, or twelve percent of post-split outstanding stock, a twenty percent dividend increase and a two-for-one stock split. The two-for-one stock split, effected in the form of a stock dividend from shares held as treasury stock, was distributed on September 30, 1996, to shareholders of record on September 16, 1996. As of December 31, 1997, 3.8 million shares have been repurchased under this authorization for \$118 million. The share repurchase program was suspended on December 4, 1997, by a resolution of MAPCO's Board of Directors which rescinded all previous authority to purchase shares of the Company's common stock. This action was taken in conjunction with the announcement of MAPCO's pending merger with the Williams Company.

During 1997, the Company sold or extended equity put options on 1.2 million shares of MAPCO's common stock with strike prices ranging from \$29 to \$32 5/8 per share. During 1996, the Company sold equity put options on 0.6 million shares of MAPCO's common stock with strike prices ranging from \$29 to \$32 1/2 per share. As of December 31, 1997 and 1996, equity put options on 0.4 million and 0.6 million shares, respectively, remained outstanding. All of the options outstanding at December 31, 1997, expired out-of-the-money during January and February 1998. MAPCO has no plans to issue further equity put options. MAPCO's Board of Directors had given Management the authorization to issue put options on up to 1.5 million shares of MAPCO's common stock.

On March 29, 1996, the Company sold its Iowa thermogas propane and fertilizer assets and its remaining liquid fertilizer assets in Arkansas, Illinois, Indiana, Ohio, Minnesota and Wisconsin to CENEX. The transaction resulted in proceeds of \$43 million which were used primarily for capital expenditures, share repurchases and general corporate purposes.

In July 1996, the Company signed an agreement with Beacon to sell substantially all of the net assets of the Coal business. That transaction was finalized on September 10, 1996. Total proceeds from the transaction of \$236 million were used to pay down debt.

Effective January 1, 1997, MAPCO sold its interest in the natural gas liquids and condensate in the West Panhandle field to Westpan NGL Company, a subsidiary of MESA Operating Company, for \$66 million. The Company recognized a gain of \$66 million on the transaction in the first quarter of 1997 as MAPCO had

no book value in the interest sold. As part of the sales agreement, MAPCO was released from its liability for its share of prior natural gas liquids over-takes.

Effective January 1, 1997, MAPCO acquired the assets of Gas Supply, Inc. ("Gas Supply"), an independent wholesale propane company based in Minneapolis, Minnesota, for approximately \$7 million, plus working capital. The acquisition has been used to expand MAPCO's current wholesale propane marketing

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activities under the trade name "Gas Supply." MAPCO also acquired Gas Supply's related product sales, a construction company, a 40,000-barrel storage facility and a rail car and truck terminal in Rosemont, Minnesota.

In April 1997, MAPCO acquired ACS Data, Ltd. ("ACS"), a company with headquarters in Manchester, England, at a cost of approximately \$11 million. ACS designs and manufactures hand-held computers and peripherals.

Effective May 21, 1997, MAPCO acquired 19 retail convenience stores located primarily in the Nashville, Tennessee market from EZ-Serve Inc. at a cost of \$12 million.

On April 30, 1997, MAPCO purchased a 5% ownership in the Alliance pipeline project. The Alliance pipeline will construct a 1,900 mile, 36-inch diameter, natural gas pipeline transmission system to carry natural gas and natural gas liquids from western Canada to the Midwestern United States for marketing throughout North America. Alliance's delivery points near Chicago include a natural gas liquids extraction facility proposed by Aux Sable Liquids Products LP, which is adjacent to the northern end of MAPCO's 10,000 mile NGL pipeline network. Construction of the pipeline is expected to begin in the second quarter of 1998 with completion anticipated by year-end 1999.

During 1997, MAPCO acquired nineteen propane companies at a cost of approximately \$39 million. These companies, with combined sales during 1996 of over 35 million gallons of propane and other related products, have market areas in Alabama, Arkansas, Indiana, Minnesota, Missouri, North Carolina, Oklahoma and South Dakota.

In July 1997, MAPCO announced plans to construct a splitter at the Mid-South Refinery that would increase the refinery's capacity for propylene production from 2,000 barrels per day to 6,000 barrels per day of the high-margin product. The refinery started production on January 19, 1998, of an incremental 2,000 barrels per day of refinery grade propylene and expects to increase production by another 2,000 barrels per day by the end of 1998. Expenditures for this project were \$7 million in 1997 and total costs are expected to be approximately \$20 million.

In 1997 MAPCO announced plans to construct a third crude unit at the Alaska Refinery that will produce an additional 17,000 barrels per day of refined products, including 14,000 barrels per day of jet fuel. The project is expected to be completed in the fourth quarter of 1998 at a cost of \$70 million.

In July 1997, MAPCO acquired a 100% ownership interest in LEXAS OIL, LLC, which had previously been an unconsolidated 50%-owned entity since January 1, 1995.

On August 1, 1997, MAPCO announced that it had reached an understanding with Enterprise Products Company ("Enterprise") to form a joint venture for the development of a natural gas liquids transportation and distribution system. It is anticipated this system will be capable of distributing product from key NGL sources in southern Louisiana with direct connections to major NGL markets, including the Louisiana river markets, Lake Charles, Louisiana and Mont Belvieu, Texas. The joint venture will be a limited liability company in which MAPCO and Enterprise will each have a 50 percent interest.

On September 5, 1997, MAPCO announced the opening of its new office under the name of Espagas, S.A. de C.V. ("Espagas") in Celaya, Guanajuato, Mexico and has future plans to open an additional office in Mexico City. Espagas markets liquefied gas (LPG) technology equipment as a part of MAPCO's TouchStar Technologies LLC.

In September 1997, MAPCO launched a new company, Thermogas Energy, LLC, that will form joint ventures with rural electric cooperatives and municipal utilities to market and distribute propane. As of December 31, 1997, Thermogas Energy, LLC, had completed joint ventures with two rural cooperatives in the state of Kentucky.

On November 24, 1997, MAPCO Inc. and The Williams Companies, Inc. announced that they had entered into a definitive merger agreement in which MAPCO will become a wholly-owned subsidiary of The Williams Companies, Inc. in a non-taxable, stock-for-stock transaction which is expected to be accounted for

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as a pooling of interest under Accounting Principles Board Opinion No. 16. See Note 2 to the Consolidated Financial Statements for additional details.

Construction for the gas gathering system for the Discovery project has been completed and gas deliveries began in December 1997. The project's gas processing plant and fractionator are under construction and both are expected to be fully operational by July 1998.

Capital expenditures in 1998 are currently expected to be about \$190 million, which includes \$93 million of operating necessities and \$97 million for

expansion projects. MAPCO expects to utilize cash from operations and short-term funding sources, proceeds from the sale of assets as needed and, if needed, proceeds from additional borrowings from the shelf registration statement filed with SEC in 1997 to meet anticipated 1998 capital expenditures. MAPCO's long-term liquidity is expected to increase since cash from operations is anticipated to exceed currently projected capital expenditures, environmental projects, debt service and dividends. MAPCO anticipates that future excess internal cash generation will be used primarily for debt reduction and to fund new capital projects.

MAPCO's existing debt and credit agreements contain covenants which limit the amount of additional indebtedness the Company can incur. Management believes, however, that MAPCO has sufficient capacity to fund its anticipated needs.

INFLATION

During the past five years, MAPCO has benefitted from the relatively low rates of inflation experienced in the United States. However, MAPCO's operating costs are influenced to a greater extent by specific price changes in oil and gas and related industries than by changes in general inflation. Crude, refined product and natural gas liquids prices are particularly sensitive to OPEC production levels and/or the attitudes of traders concerning the supply and demand balance in the near future. These costs could increase with a possible adverse effect on MAPCO's profitability. Although every effort will be made to do so, it is possible that MAPCO, like many other companies, may not be able to adjust its sales prices to maintain parity with inflation-driven operating costs.

OTHER

MAPCO has completed an internal assessment of the applications, engineering systems, technical infrastructure, imbedded systems and other components in regard to the year 2000. During 1997, the Company expensed \$1 million of costs associated with modifying MAPCO's internal-use software and hardware for the year 2000 and the projected total costs that will be expensed during 1998 through the year 2000 is expected to be approximately \$10 million. In addition, the Company has replaced or is replacing six major applications, including its financial accounting system, pipeline operations system, propane operations system, retail petroleum store reporting system, materials and management system and payroll and human resources system, whose costs are being capitalized. The Company has capitalized \$27 million associated with these systems and the total amount which the Company expects to capitalize will be approximately \$65 million. The Company expects to have its remediation efforts completed by the end of 1999, and does not expect any material impact on its results of operations, liquidity or financial position due to incomplete or untimely resolution of the year 2000 issue.

MAPCO is continuing its review of the potential costs or consequences of incomplete or untimely resolution of the year 2000 issue by other entities. The Company is not able, at this time, to determine what impact incomplete or untimely resolution of the year 2000 issue by other entities could have. At this time, the Company has no reason to believe that this issue could materially impact MAPCO's financial position, liquidity or results of operations.

MAPCO maintains property and liability insurance at limits believed to be sufficient to cover estimated potential risks. Losses up to deductible amounts of the various coverages would not have a material effect on MAPCO's financial position, liquidity or results of operations.

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RESULTS OF OPERATIONS

MAPCO's results of operations were significantly influenced by the following major 1997 events:

- The November 1997 announcement of and pending merger with The Williams Company, Inc.
- Sale of the Company's natural gas liquids and condensate interests in the West Panhandle field ("Westpan sale"), which was effective January 1, 1997.
- Warmer-than-normal weather patterns throughout the fall and winter months of 1997.
- The operations of several start-up companies and the implementation of a number of growth initiatives.

INCOME STATEMENT

1997 Results Compared to 1996

Income from continuing operations was \$105 million in 1997 compared to \$130 million in 1996. Excluding a \$40 million (\$66 million pre-tax) gain on the Westpan sale from 1997 and a \$13 million gain (\$21 million pre-tax) on the sale of propane and fertilizer assets in 1996 to CENEX ("CENEX sale"), income from continuing operations decreased \$52 million, or 44%, from 1996.

Net income in 1997 was \$97 million which included a \$6 million loss on disposal of the Coal operations and a \$1 million charge for a cumulative effect of a change in accounting principle. The loss on disposal of Coal operations, net of income taxes, was \$6 million and includes liabilities recorded in association with certain guarantees made pursuant to the sale of the Coal

business in 1996. Net income in 1996 was \$98 million which included \$15 million of income from the discontinued Coal operations and a \$47 million loss on the disposal of the Coal operations. A discussion of the discontinued Coal operations is contained in Note 3 to the consolidated financial statements.

Diluted earnings per common share from continuing operations, excluding the impact of the Westpan sale from 1997 and the gain on Cenex sale from 1996 results, were \$1.17 in 1997 compared to \$2.04 in 1996. Diluted weighted average common shares outstanding in 1997 were 55.6 million compared to 57.6 million in 1996.

Sales and operating revenues by business unit were as follows (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,	
	1997	1996
<S>	<C>	<C>
Natural Gas Liquids.....	\$ 751	\$ 716
Propane Marketing.....	413	430
Petroleum Refining.....	2,309	1,813
Retail Petroleum.....	733	715
Other.....	25	--
Eliminations.....	(383)	(321)
	-----	-----
	\$3,848	\$3,353
	=====	=====

</TABLE>

Natural Gas Liquids sales and operating revenues increased \$35 million principally due to increased trading sales and pipeline revenues, partially offset by lower Westpan revenues. Trading sales from the Canada operations increased \$53 million as those operations had only four months of activity in 1996. Other trading sales decreased \$13 million reflecting significantly lower NGL prices in the current year. Pipeline revenues increased \$3 million principally due to new plant connections and new customer transportation agreements, partially offset by lower propane heating revenues which were negatively impacted by a poor crop-drying season and above normal temperatures in 1997 compared to colder temperatures in 1996. Revenues decreased \$10 million due to the January 1997 sale of MAPCO's interest in West Panhandle field. Of the \$35 million

increase in NGL's sales and operating revenues, \$68 was attributable to increased volumes, partially offset by \$33 million decrease in sales attributable to lower prices.

Propane Marketing sales and operating revenues decreased \$17 million. Excluding the impact of the CENEX sale from 1996 operating results, revenues increased \$7 million as wholesale sales increased \$21 million, partially offset by a \$13 million decrease in retail sales. The increase in wholesale sales reflects the impact of additional volumes from the acquisition of Gas Supply in January 1997. The decrease in retail sales was due to decreased volumes and slightly lower prices. Although volume increases were realized from the nineteen acquisitions completed during 1997, these increases were more than offset by decreased demand as a result of unusually warm temperatures throughout Propane Marketing's market areas. Of the \$7 million overall increase in Propane Marketing's sales, \$8 million was attributable to increased volumes, partially offset by a \$1 million decrease in sales attributable to reduced sales prices.

Petroleum Refining sales and operating revenues increased \$496 million, primarily due to increased volumes at the Mid-South Refinery. The increase in sales principally reflects increased demand for petroleum products, aggressive marketing in the Memphis and Ohio River Valley areas and the inclusion of Texas Oil operations, which prior to July 1997 were unconsolidated. Total Mid-South Refinery sales volumes increased 68 thousand barrels per day, of which 9 thousand barrels per day were supplied through increased production at the refinery and 59 thousand barrels per day through increased purchases of refined product. Sales volumes at the Alaska Refinery increased 4% over 1996 levels, despite the negative impact of fourth quarter 1997 events, which included sharp declines in West Coast prices and the Asian financial crisis. Of the \$496 million increase in Petroleum Refining sales, \$631 million was attributable to increased volumes, partially offset by a \$135 million decrease in sales attributable to lower prices.

Retail Petroleum sales and operating revenues increased \$18 million as increased gasoline and merchandise sales were partially offset by decreased diesel sales. Gasoline sales increased \$11 million due to a 13 million gallon increase in sales volumes, primarily attributable to the May 1997 EZ-Serve acquisition, partially offset by the impact of an average 2 cent per gallon decrease in pump prices. Diesel sales decreased \$15 million due to a 10 million gallon decrease in volumes and an average 2 cent per gallon decrease in pump prices. The decrease in diesel sales volumes was due to the absence of the Rising Fawn travel center and the discontinuation of the Fuelman operations. The Rising Fawn travel center, which burned during 1996, has been rebuilt and was re-opened on December 1, 1997. The Fuelman operations were discontinued because of the start-up of MAPCO's FleetOne business. Merchandise sales increased \$22 million due to the increased store count from the EZ-Serve acquisition and an overall increase in per store merchandise sales.

Other sales and operating revenues include FleetOne and TouchStar revenues.

FleetOne had revenues of \$16 million principally from the sale of fuel from unattended fueling sites. TouchStar had revenues of \$9 million, primarily from ACS Data Ltd. which was acquired in April 1997.

Outside purchases and operating expenses by business unit are provided below (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,			
	1997		1996	
	OUTSIDE PURCHASES	OPERATING EXPENSES	OUTSIDE PURCHASES	OPERATING EXPENSES
<S>	<C>	<C>	<C>	<C>
Natural Gas Liquids.....	\$ 465	\$125	\$ 401	\$138
Propane Marketing.....	180	91	235	72
Petroleum Refining.....	2,054	113	1,617	97
Retail Petroleum.....	334	106	320	85
Other.....	17	11	--	--
	-----	-----	-----	-----
	\$3,050	\$446	\$2,573	\$392
	=====	=====	=====	=====

</TABLE>

Natural Gas Liquids outside purchases increased \$64 million because of increased trading purchases. Purchases by the Canadian operations, which had only four months of operations in 1996, increased \$52 million. Other trading purchases increased \$12 million principally due to increased volumes. Operating

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expenses decreased \$13 million primarily because of the absence of Westpan operating expenses, which were \$13 million in 1996. Transportation costs were essentially unchanged as increased power costs, reflecting increased pipeline product movements and higher natural gas prices, were offset by lower property taxes and other costs.

Propane Marketing outside purchases decreased \$55 million. Excluding the impact of the CENEX transaction from 1996 purchases, outside purchases decreased \$38 million, primarily due to decreased amounts for propane products. Average wholesale propane costs decreased 11 cents per gallon which reduced outside purchases by \$59 million. Purchased propane volumes increased 50 million gallons, or \$19 million, partially offsetting the impact of lower prices. Operating expenses increased \$19 million; however, excluding the operating

expenses related to the assets sold to CENEX, operating expenses increased \$23 million. This increase primarily reflects increased salary and wages associated with acquisitions and growth initiatives during 1997 and increased supplies, bad debt, environmental and other costs.

Petroleum Refining outside purchases increased \$437 million as increased purchases by the Mid-South Refinery were partially offset by reduced purchases by the Alaska Refinery. Mid-South purchases increased \$446 million and were attributable to increased purchases of crude, reflecting the increased throughput volumes, increased purchases of refined products and the inclusion of Lexas Oil purchases. The Alaska Refinery purchases decreased \$9 million reflecting a 379 thousand barrel decrease in throughput which reduced overall crude purchases. Operating expenses increased \$16 million due to increased costs by both the Mid-South and Alaska Refineries. Mid-South's operating expenses increased \$5 million, primarily due to increased crude throughput. Crude throughput at the Mid-South Refinery increased 10% and operating expenses increased 8% over 1996. Alaska's operating expenses increased \$11 million due to planned increases in maintenance activities, including a mini-turnaround on the Sufolane unit and maintenance on the crude tanks and heat exchangers, increased environmental costs and increased bonus, pension and other benefit costs.

Retail Petroleum outside purchases increased \$14 million due to increased purchases of gasoline and merchandise, which were partially offset by decreased purchases of diesel fuel. Purchases of gasoline increased \$14 million, reflecting the 13 million gallon increase in gasoline sales for the year. Diesel purchases decreased \$15 million due to the decreased sales volumes combined with a 3 cent per gallon decrease in wholesale prices. Merchandise purchases increased \$17 million to meet the increase in overall merchandise sales for the year. Operating expenses increased \$21 million. Increases in salaries and wages, benefits, advertising, professional services and environmental costs accounted for most of the increase. These increases were the result of the increased store count from the EZ-Serve acquisition, and increased per store expenses associated with the implementation of strategic growth initiatives.

Other outside purchases of \$17 million included fuel purchases by FleetOne and purchases of computer products for resale by TouchStar. Operating expenses of \$11 million included the operating costs for ACS Data Ltd, which was acquired during 1997 and start-up costs for FleetOne and TouchStar. FleetOne's start-up costs included termination of Fuelman agreement, consulting charges associated with marketing and business development, software development costs and expenses related to the start-up of operations in Mexico. Start-up expenses for TouchStar included Espagas, TouchStar's new Mexican operations and other salaries and consulting fees.

Selling, general and administrative ("SG&A") expenses increased \$34 million principally due to higher costs in Corporate, Propane Marketing and Petroleum Refining. Corporate's SG&A expense increase was principally the result of increased labor and associated costs reflecting an increase in number of

employees over 1996. Also included in the increase was \$2 million for merger-related expenses and establishing, in August 1996, the Marketing and Business Development department to develop new business opportunities for the Company and increased outside services, legal and travel expenses. The increase in Propane Marketing's SG&A expenses reflects increased salary, benefit, travel and outside services costs associated with the acquisitions and market expansion programs conducted during the year. Petroleum Refining's SG&A increase reflects increased salary, benefit and outside services costs, primarily related to reorganization costs at the Mid-South Refinery, and increased salary, benefit and travel costs at the Alaska Refinery.

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Interest and debt expense decreased \$5 million. Capitalized interest, primarily associated with the Discovery Project, increased \$6 million over the same period in 1997. Otherwise, decreased interest on commercial paper and the ESOP loan were offset by increased interest expense on the 12-year and 30-year bonds issued during the first quarter of 1997.

The \$66 million gain on the sale of net assets held for sale in 1997 reflects the gain on sale of MAPCO's interest in the liquids and condensate in the West Panhandle field in the first quarter of 1997. The \$21 million gain in 1996 was a gain on sale of the fertilizer and Iowa propane assets to CENEX.

Other income in 1997 included \$4 million for the gain on the termination of interest rate swap agreements, which was partially offset by a \$3 million additional accrual associated with the Texas explosion litigation (see Note 16 to the Consolidated Financial Statements). Other income in 1996 included \$2 million for interest received from the Beacon Investment Group associated with the sale of the Coal segment, a \$4 million gain on the sale of two corporate airplanes and a \$1 million gain on the sale of an in-house developed business consulting concept, partially offset by \$1 million of expenses for Coal operations and other charges.

MAPCO's effective tax rate for 1997 was 40.2% compared to 38.6% in 1996. The primary reason for the increase in the effective rate was the absence of coal depletion during 1997. The difference between the statutory Federal income tax rate of 35% and the effective tax rate for 1997 and 1996 was due to state income taxes, adjustments to prior year accruals and depletion expense related to the coal operations.

1996 Results Compared to 1995

Income from continuing operations was \$130 million in 1996 compared to \$64 million in 1995. Excluding a \$13 million (\$21 million pre-tax) gain on the sale of assets to CENEX from 1996 results, income from continuing operations increased \$53 million, or 83%, over 1995. Income from continuing operations in

1995 was reduced \$6 million (\$10 million pre-tax) for reorganization charges.

Net income in 1996 was \$98 million which included \$15 million of income from the discontinued Coal operations and a \$47 million loss on the disposal of the coal operations. A discussion of the discontinued Coal operations is contained in Note 3 to the consolidated financial statements. Net income in 1995 was \$75 million and included \$11 million of income from discontinued operations.

Income from discontinued operations was reduced \$19 million (\$30 million pre-tax) in 1995 from the impact of applying SFAS No. 121.

Diluted earnings per common share from continuing operations, excluding the gain on sale of assets CENEX, were \$2.04 in 1996 compared to \$1.08 in 1995. Diluted earnings per common share from net income were \$1.69 in 1996 compared to \$1.25 in 1995. Diluted weighted average common shares outstanding in 1996 were 57.6 million compared to 59.7 million in 1995.

Sales and operating revenues by business unit were as follows (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,	
	1996	1995
<S>	<C>	<C>
Natural Gas Liquids.....	\$ 716	\$ 550
Propane Marketing.....	430	338
Petroleum Refining.....	1,813	1,574
Retail Petroleum.....	715	631
Eliminations.....	(321)	(236)
	-----	-----
	\$3,353	\$2,857
	=====	=====

</TABLE>

Sales and operating revenues increased \$496 million in 1996, due to increased sales by all of the operating units.

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Natural Gas Liquids sales and operating revenues increased \$166 million principally due to increased trading and pipeline revenues. Trading sales increased \$130 million as market prices increased over 11 cents per gallon on slightly higher volumes. Pipeline revenues increased \$42 million principally due to increased volumes from the Four Corners Pipeline loop project completed in

the first quarter of 1996, increased movements of demethanized mix from Rocky Mountain origins to the Gulf Coast and increased movements of propane to the heating markets in the Midwest. Eagle Oil revenues decreased \$5 million as those operations were phased out in January 1996. Overall, \$116 million of the sales increase was attributable to higher prices and \$50 million due to increased volumes.

Propane Marketing sales and operating revenues increased \$92 million, despite the divestiture of Propane Marketing's liquid fertilizer and Iowa propane operations during 1996. Excluding the divested Iowa operations, Retail Marketing's sales increased \$126 million. This increase was primarily attributable to increased retail, wholesale and spot propane sales which were partially offset by lower fertilizer sales. Retail propane sales increased \$66 million as increased demand due to colder weather resulted in a 39 million gallon increase in retail propane volumes combined with a 17% increase in average retail prices. Wholesale and spot propane sales increased \$66 million due to increased prices. Fertilizer sales decreased \$8 million reflecting the divestiture of those operations during 1996. Overall, \$54 million of Propane Marketing's sales increase was attributable to higher prices and \$72 million due to increased volumes.

Petroleum Refining's sales and operating revenues increased \$239 million due to increased production and sales volumes at the Memphis and North Pole Refineries, as well as higher sales prices at the North Pole Refinery. Production at the Memphis Refinery increased 19,512 barrels per day and total barrels sold increased by 25,741 barrels per day. The increase in sales volumes was partially offset by lower average refined product sales prices of \$2.95 per barrel. Production at the North Pole Refinery increased 3,753 barrels per day, total barrels sold increased 5,124 barrels per day and average refined product sales prices increased \$3.62 per barrel. The \$239 million sales increase was attributable to a \$329 million increase in volumes, partially offset by a \$90 million decrease in average sales prices.

Retail Petroleum's sales and operating revenues increased \$84 million because both fuel and merchandise sales increased. Gasoline sales increased \$29 million primarily due to a \$0.13 per gallon increase in average pump prices which more than offset the impact of a 5 million gallon decrease in gasoline volumes sold. Diesel sales increased \$39 million as average pump prices increased \$0.14 per gallon and volumes increased by almost 18 million gallons. Merchandise sales increased \$16 million due primarily to increased volumes. Overall, \$56 million of Retail Petroleum's sales increase was attributable to higher prices and \$28 million to increased volumes.

Outside purchases and operating expenses by business unit are provided below (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,			
	1996		1995	
	OUTSIDE PURCHASES	OPERATING EXPENSES	OUTSIDE PURCHASES	OPERATING EXPENSES
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Natural Gas Liquids.....	\$ 401	\$138	\$ 292	\$114
Propane Marketing.....	235	72	172	69
Petroleum Refining.....	1,617	97	1,408	96
Retail Petroleum.....	320	85	315	84
	-----	-----	-----	-----
	\$2,573	\$392	\$2,187	\$363
	=====	=====	=====	=====

</TABLE>

Natural Gas Liquids outside purchases increased \$109 million. The increase was principally due to increased trading purchases caused by higher market prices, partially offset by decreased Eagle Oil purchases. Operating expenses increased \$24 million primarily because of increased power costs and Westpan expenses. Power costs increased due to increased pipeline product movements and higher natural gas prices. Westpan operating expenses increased due to accruals for severance and other costs associated with the closure of the Bivins gas plant.

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Propane Marketing outside purchases increased \$63 million; however, excluding the divested Iowa operations, the increase in outside purchases was \$69 million. The increase was attributable to the additional purchases required to meet the increase in retail, wholesale and spot sales volumes and higher wholesale propane prices. These increases were partially offset by lower fertilizer purchases due to the divestiture of that product line during 1996. Operating expenses increased \$3 million; however, excluding the Iowa operating expenses from the totals, operating expenses increased \$10 million due to general increases in various expense categories that were related to the increased sales volumes.

Petroleum Refining outside purchases increased \$209 million because of the increased volume of crude purchases associated with the increased production at the refineries, higher average crude prices and increased volumes of refined products purchased. Operating expenses increased \$1 million principally due to costs associated with the increased crude throughput.

Retail Petroleum outside purchases increased \$5 million, principally due to additional merchandise purchases to meet increased demand. Product purchases

from the Petroleum Refining business unit, which are not reflected in the above tables due to eliminations, increased \$63 million due to higher gasoline and diesel prices and increased diesel volumes. Operating expenses increased \$1 million.

Selling, general and administrative expenses increased \$9 million principally due to higher salary and benefit costs associated with restructuring MAPCO's operations from segments into the business units and establishing a Business Development department, in January 1996, whose purpose is to develop new business opportunities.

The \$10 million reorganization charge in 1995 related to reorganizations in the Natural Gas Liquids and Propane Marketing business units and in Corporate. See Note 13 in the consolidated financial statements for additional information.

The \$21 million gain on sale of net assets held for disposal related to the Iowa propane and liquid fertilizer assets sold to CENEX in March 1996. See Note 4 in the consolidated financial statements for additional information.

Other income in 1996 included \$2 million for interest received from the Beacon Investment Group associated with the sale of the Coal segment, a \$4 million gain on the sale of two corporate airplanes and a \$1 million gain on the sale of an in-house developed business consulting concept, partially offset by \$1 million of expenses for Coal operations and other charges.

MAPCO's effective tax rate for 1996 was 38.6% compared to 37.2% in 1995. The increase in the effective tax rate was primarily attributable to the fact that 1995 included a full year of depletion expense while 1996 included only a partial year. The difference between the statutory Federal income tax rate of 35% and the effective tax rate for 1996 and 1995 was due to state income taxes, adjustments to prior year accruals and depletion expense.

OPERATING PROFIT

1997 RESULTS COMPARED TO 1996

Operating profit by business unit was as follows (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,	
	1997	1996
<S>		
Natural Gas Liquids.....	\$183	\$137
Propane Marketing.....	(6)	65

Petroleum Refining.....	97	64
Retail Petroleum.....	12	30
Other.....	(9)	--
	----	----
	\$277	\$296
	====	====

</TABLE>

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Natural Gas Liquids Results

Excluding the \$66 million gain on the Westpan sale from current year results, operating profit decreased \$20 million. The Westpan operations generated \$18 million of operating profit in 1996 which accounts for most of the decrease. Operating profit in 1997 was reduced \$5 million for additional charges associated with the Texas explosion litigation (see Note 16 to the Consolidated Financial Statements).

Propane Marketing Results

Propane Marketing's results in 1996 include a \$21 million gain on the sale of assets to CENEX. Excluding this gain and the profit from the operations associated with the assets sold from 1996, operating profit was \$41 million in 1996. The \$47 million decrease in operating profit from 1996 primarily reflects increased operating, general and administrative and depreciation expense. Operating expenses increased primarily due to increased salary and wages associated with acquisitions and growth initiatives during 1997 and increased supplies, bad debt, environmental and other costs. The increase in Propane Marketing's general and administrative expenses reflects increased salary benefit, travel and outside services costs associated with the acquisitions and market expansion programs conducted during the year. The increase in depreciation costs reflect the increase in capital equipment spending and acquisitions in 1997.

Petroleum Refining Results

Petroleum Refining's operating profit increased \$33 million as margins on processed barrels sold and total sales volumes increased at both the Mid-South and the Alaska Refineries. Increased operating, general and administrative and depreciation costs partially offset the favorable impact of increased margins and volumes.

Retail Petroleum Results

Retail Petroleum's operating profit decreased \$18 million. Gasoline gross profit decreased \$3 million as decreased margins more than offset the impact of

increased sales gallons. Diesel gross profit was unchanged as increased margins offset the impact of lower sales gallons. Merchandise gross profit increased \$5 million due to significantly higher sales volumes, with margins decreasing only slightly from 1996. Total expenses increased \$20 million due to increases in salaries and wages, benefits, advertising, professional services and environmental costs resulting from the increased store count from the EZ-Serve acquisition, and increased per store expenses associated with the implementation of strategic growth initiatives.

Other Results

FleetOne's operating loss in 1997 was \$7 million which included a \$3 million charge associated with the termination of the Fuelman franchise, \$1 million for software development fees and \$3 million of other start-up costs. TouchStar's operating loss of \$2 million included operating profit of \$1 million by ACS Data Ltd., offset by \$3 million of operating losses, primarily due to start-up costs by Espagas and Clean Fuel Technologies.

1996 RESULTS COMPARED TO 1995

Operating profit by business unit was as follows (in millions):

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,	
	1996	1995
	----	----
<S>	<C>	<C>
Natural Gas Liquids.....	\$137	\$104
Propane Marketing.....	65	35
Petroleum Refining.....	64	36
Retail Petroleum.....	30	13
	----	----
	\$296	\$188
	====	====

</TABLE>

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Natural Gas Liquids Results

The \$33 million increase in operating profit was primarily attributable to increased pipeline profits. Pipeline revenues increased substantially over 1995 due to additional volumes from the completion of the Four Corners loop project and because ethane recoveries and shipments to Gulf Coast destinations were

strong all year. Pipeline revenues and operating profit in 1995 were adversely affected by lower demethanized mix shipments created by low ethane prices on the Gulf Coast.

Propane Marketing Results

The gain on sale of assets to CENEX accounts for \$21 million of the \$30 million operating profit increase. Excluding the CENEX gain and the operating profit associated with these operations, operating profit increased \$15 million. This improvement resulted from the increase in home heating and agricultural propane sales caused by colder-than-normal weather and a strong crop drying season. In addition, wholesale profits increased primarily because of increased margins which resulted primarily from higher product sales prices.

Petroleum Refining

The \$28 million operating profit increase primarily reflects increased profits at the Memphis refinery. Profits at the Memphis Refinery increased \$33 million as crude throughput increased 24%, total barrels sold increased 23% and margins improved 17% over 1995. The margin increase was due to higher average crude costs decreasing more than the decrease in average product sales prices. The production gains were attributable to capital improvements made to the refinery during a major turnaround in the spring of 1995. Production was negatively impacted in 1995 as the Memphis Refinery was shut-down for 4 weeks to complete the scheduled turnaround. Operating profit at the North Pole Refinery decreased \$5 million as a 9% increase in production was more than offset by lower margins. Margins decreased 15% from 1995 primarily because of higher crude costs.

Retail Petroleum

Operating profit increased \$17 million primarily due to increased merchandise profits as both sales volumes and margins improved over 1995. Merchandise sales increased \$15 million and margins improved 3.6% over 1995 which resulted in a \$12 million increase in merchandise profits. Profits on gasoline sales increased \$2 million as higher gasoline margins more than offset the impact of lower sales volumes. Profits on diesel sales increased \$1 million as sales volumes increased 18 million gallons and margins remained essentially unchanged.

ENVIRONMENTAL ISSUES

Estimated liabilities for environmental costs, primarily in the Petroleum Refining and Retail Petroleum business units, have been determined independently of any potential claims for recovery. Estimated liabilities for environmental matters were \$24 million and \$28 million as of December 31, 1997, and 1996, respectively. Receivables recorded in connection with laws permitting reimbursement by the states of certain expenses associated with underground

storage tank containment problems and repairs were \$13 million and \$15 million at December 31, 1997 and 1996, respectively.

OTHER MATTERS

Natural Gas Liquids

In November 1995, Mid-America Pipeline, Amoco Pipeline and Navajo Pipeline announced the formation of a joint venture under the name, Rio Grande Pipeline Company ("Rio Grande"). Rio Grande, which began operations in the first quarter of 1997, transport NGLs from Mid-America Pipeline's Hobbs Station in Texas and other Mid-America Pipeline origins to the Pemex Gas y Petroquimica Basica's ("PEMEX") Mendex terminal in Ciudad Juarez, Mexico. The Mexican customer purchasing the NGLs is

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PMI Trading Company. Rio Grande is the first pipeline to carry NGL shipments across the United States/ Mexico border.

Effective January 1, 1997, MAPCO sold its interest in the natural gas liquids and condensate in the West Panhandle field to Westpan NGL Company, a subsidiary of MESA Operating Company, for \$66 million. Since 1991, MAPCO's West Panhandle field gas supplier took more than its percentage ownership share of the field's production. The cumulative effect of this acceleration in gas taken resulted in the Westpan operations having a 31 billion cubic feet and \$30 million over-take position at December 31, 1996. As part of the sale agreement with Westpan NGL Company, MAPCO was released from its liability for its share of prior NGL over-takes.

In February 1997, MAPCO Energy L.L.C., a Delaware limited liability company wholly-owned by MAPCO ("MAPCO Energy"), formed two joint ventures with Texaco Exploration and Production Inc. ("Texaco") under the name Discovery Producer Services, L.L.C. and Discovery Gas Transmission, L.L.C. ("Discovery"), which owns and operates the Discovery Project. MAPCO Energy and Texaco each own 50% of the joint ventures and Texaco is the operator. Construction of a 150-mile natural gas pipeline of varying diameters between 12 inches and 30 inches from off-shore discovery wells in the Gulf of Mexico to gas processing and fractionation facilities in southern Louisiana has been completed with first deliveries of gas from the pipeline in December 1997. The joint venture is currently in the process of constructing a cryogenic gas processing plant with a capacity of approximately 600 million cubic feet of gas per day near Larose, Louisiana, and the expansion of a natural gas liquids fractionator in Paradis, Louisiana. Both the fractionator and the cryogenic gas processing plant are expected to be operational by mid-1998.

On April 7, 1992, a liquefied petroleum gas explosion occurred near an

underground salt dome storage facility near Brenham, Texas and owned by an affiliate of the Company, Seminole Pipeline Company. The matter was investigated by the National Transportation Safety Board and the Texas Railroad Commission. A discussion of this matter and its effect on MAPCO is contained in Note 16 to the consolidated financial statements.

Propane Marketing

In March 1996, Thermogas Company divested its Iowa propane and liquid fertilizer assets to CENEX Inc. The transaction, which was completed on March 31, 1996, also involved the sale to CENEX Inc. of the remaining Thermogas liquid fertilizer assets in Arkansas, Illinois, Indiana, Minnesota, Ohio and Wisconsin. Sales and operating revenues for the assets involved in this transaction were \$24 million and \$69 million in 1996 and 1995, respectively, and operating profit was estimated to be \$2 million in 1996 and \$7 million in 1995.

On January 6, 1997, Propane Marketing announced that, effective January 1, 1997, it had acquired Gas Supply, Inc., an independent wholesale propane company based in Minneapolis, Minnesota. The acquisition will be used to expand MAPCO's current wholesale propane marketing activities under the trade name, Gas Supply. Gas Supply, Inc., marketed approximately 120 million gallons of propane to the Central and Northeastern United States in 1996. Gas Supply also has related product sales, a construction company, a 40,000-barrel storage facility and a rail car and truck terminal in Rosemont, Minnesota.

Other

In September 1996, MAPCO announced the formation of a new company, MAPCO Canada Energy Inc., with headquarters in Calgary, Alberta. The new company's mission is to develop strategic business opportunities related to the production and transportation of natural gas liquids and petroleum products.

On February 4, 1997, MAPCO announced the formation of two new businesses, InfiNet Solutions, LLC, whose name was changed during 1997 to TouchStar Technologies L.L.C. ("TouchStar"), and MAPCO Fleet Systems, whose name was changed during 1997 to FleetOne L.L.C., to expand the Company into mobile information management systems and bundled services for commercial fleets. FleetOne's operations include providing fleet operators with motor fuel, data management and service alternatives. TouchStar's operations

include offering information management systems to track operations and control inventories of energy and other products to improve distribution efficiency and customer service. New technology in the form of a mobile, hand-held computer system has been designed to improve record keeping and distribution routing.

MAPCO Coal's wholly-owned subsidiary, Webster County Coal Corporation, owned and operated the Retiki Coal Mine. The Retiki mine operated under a cost-plus management fee contract with Big Rivers Electric Corporation ("Big Rivers") whereby the production from the Retiki mine was sold exclusively to Big Rivers. In January of 1995, Webster County Coal Corporation entered into a Partial Settlement Agreement with Big Rivers that closed the Retiki mine. Webster County Coal Corporation and Big Rivers have litigated the payment responsibility for certain costs, associated with the operation of the Retiki mine, which Big Rivers had disputed. The trial was conducted in late 1995. Before a verdict was rendered, Big Rivers filed for Chapter 11 bankruptcy protection. As part of a plan of reorganization, most of the major creditors agreed to settle their claims with Big Rivers. MAPCO Equities Inc., a wholly-owned subsidiary of MAPCO and successor to Webster County Coal Corporation's interest in the litigation with Big Rivers, also agreed with Big Rivers to settle its claim for \$6 million. Big Rivers' plan of reorganization (which included this agreed settlement of MAPCO Equities Inc.'s claim) was confirmed by the Bankruptcy Court on June 9, 1997, subject to a number of conditions, one of which called for Big Rivers to file for and obtain approval of its future rates for electricity in Kentucky. That rate filing has been made and hearings before the Kentucky Public Service Commission have been held, but a decision is still pending. Pacific Corp. appealed the Bankruptcy Court's confirmation order, and that appeal is also pending.

In 1996 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The provisions of SFAS No. 125 require an entity to recognize the financial and servicing assets it controls and the liabilities it has incurred under the financial components approach, and distinguishes transfers of financial assets that are sales from financial assets that are secured borrowings. SFAS No. 125 also establishes new accounting requirements for pledged collateral. The adoption of certain provisions of SFAS No. 125 were delayed from 1997 to 1998 by the issuance of SFAS No. 127, Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125. The Company will adopt the applicable provisions of SFAS No. 125 in 1998. The Company does not expect such adoption to have a material impact on its current results of operations, financial position, or cash flows.

In 1997 the FASB issued SFAS No. 130, Reporting Comprehensive Income. The provision of SFAS No. 130 establish new rules for the reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The new rules require that all items that are recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Company will adopt SFAS in 1998 and does not expect that such adoption will have a material impact on results of operations, financial position or cash flows.

In 1997, the FASB issued SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. The provisions of SFAS No. 131 require public companies to use a management approach to determining their operating segments. This management approach model defines operating segments as revenue-producing components of the enterprise for which separate financial information is produced internally and are subject to evaluation by the chief operating decision maker in deciding how to allocate resources to segments. SFAS No. 131 also expands the financial and descriptive information disclosures relative to the identified operating segments. MAPCO will adopt SFAS in 1998 and does not expect that such adoption will have a material impact on results of operations, financial position or cash flows.

In February 1998, the FASB issued SFAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits. The provisions of SFAS No. 132 require an entity to revise disclosures about pension and other postretirement benefit plans. The statement does not change the measurement or recognition of those plans. It standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable. The statement also requires additional information on changes in the benefit obligations and fair values of plan assets that will facilitate financial analysis and eliminates certain disclosures that are no

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longer useful. The Company will adopt the applicable provisions of SFAS No. 132 in 1998. The Company does not expect such adoption to have a material impact on its results of operations, financial position or cash flows.

GENERAL MANAGEMENT DISCUSSION

The consolidated financial statements were prepared by management who is responsible for their integrity and objectivity. These financial statements, which include amounts based on management's best estimates and judgments, were prepared in accordance with generally accepted accounting principles. The consolidated financial statements were independently audited by Deloitte & Touche LLP, whose report appears on page F-1.

MAPCO maintains a system of internal controls that is designed to provide reasonable assurance that financial records are accurate, assets are protected, and consolidated financial statements are stated fairly. This system is supported by the selection and training of qualified personnel, management oversight, proper division of responsibilities, the dissemination of written policies and procedures, and an internal audit program to monitor the system's effectiveness. Management believes the present system of internal controls effectively provides the assurances described above.

The Board of Directors, through its Audit Committee, composed of Directors

not employed by the Company, monitors management's financial reporting responsibilities. The Audit Committee meets periodically with representatives of management, internal audit, and Deloitte & Touche LLP, to discuss specific accounting, reporting, internal control, and regulatory compliance matters. Deloitte & Touche LLP and the Company's internal auditors have unlimited access to members of the Audit Committee.

Approximately 15% of MAPCO stockholders participate in the voluntary Dividend Investment Plan whereby cash dividends are used to purchase additional MAPCO common stock. This service is free, and is administered by the Harris Trust Company of New York. Stockholders with questions about their accounts should contact the Harris Bank, Dividend Reinvestment, P.O. Box A-3309, Chicago, Illinois 60690-9939 or call Harris Bank at (312) 461-2731.

During 1997, MAPCO declared quarterly dividends of \$0.15 per share. During the first three quarters of 1996, MAPCO declared quarterly dividends of \$0.125 per share and in the fourth quarter of 1996, increased the dividend to \$0.15 per share. During 1995, MAPCO declared quarterly dividends of \$0.125 per share. Dividends were payable in March, June, September, and December. The annual dividend in 1997 was \$0.60 per share and in 1996 and 1995, the annual dividend was \$0.525 per share and \$0.50 per share (as restated for the stock split, effected in the form of a stock dividend from shares held as treasury stock, in 1996), respectively.

MAPCO common stock is traded on the New York, Chicago, and Pacific Stock Exchanges under the symbol MDA. MAPCO had 5,319 stockholders of record on December 31, 1997.

The high and low closing prices of MAPCO common stock on the New York Stock Exchange during the quarterly periods of 1997 and 1996 (as restated for the 1996 stock split) were as follows:

<TABLE>
<CAPTION>

QUARTER	1997		1996	
	HIGH	LOW	HIGH	LOW
<S>	<C>	<C>	<C>	<C>
First.....	\$34.25	\$31.00	\$28.69	\$26.69
Second.....	32.13	28.88	29.63	27.88
Third.....	32.94	29.50	29.81	26.81
Fourth.....	46.25	32.13	34.75	29.75

</TABLE>

The closing price of MAPCO's common stock on the New York Stock Exchange on December 31, 1997 was \$46.25 and on February 13, 1998 was \$52.19.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements of MAPCO Inc., together with the report thereon of Deloitte & Touche LLP dated January 27, 1998 (February 26, 1998, as to Notes 2 and 16) and the supplementary financial data specified by Item 302 of Regulation S-K are set forth on pages F-1 through F-28 hereof. See Item 14 for Index.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

(a) Directors of the Registrant

The Board of Directors is divided into three classes with the term of office of the Directors of each class ending in different years. The Class I, II and III Directors are to serve until the Annual Meeting of Stockholders in 1998, 1999 and 2000, respectively, or until their successors are elected. There are currently no vacancies on the Board of Directors.

The following tabulation provides information as to each Director of the Company.

<TABLE>
<CAPTION>

DIRECTOR -----	CLASS -----
<S>	<C>
Donald L. Mellish, 70.....	I
Anchorage, Alaska. Director since June 1981. Chairman of the Executive Committee since 1985 and a Director of National Bancorp of Alaska, Inc. since 1964.	
Robert L. Parker, 74.....	I
Tulsa, Oklahoma. Director since May 1986. Chairman of the Board of Parker Drilling Company, an international oil and gas drilling company. Presently, a Director of Bank of Oklahoma Financial Corporation, Clayton Williams Energy, Inc., Norwest Bank of Texas (Kerrville), Southern Methodist University, St. Francis Hospital (Chairman) and the Development Board of Texas University.	

James E. Barnes, 64..... II
 Tulsa, Oklahoma. Director, Chairman of the Board, President and Chief Executive Officer of the Company since September, 1995. Director, Chairman of the Board and Chief Executive Officer of the Company from December 1991 to September 1995. Director, Chairman of the Board, President and Chief Executive Officer of the Company from May 1986 to December 1991. Director, President and Chief Executive Officer of the Company from February 1984 to May 1986. Advisory, non-voting Director, Senior Executive Vice President and Chief Operating Officer of the Company from June 1983 to February 1984. Presently a Director of Bank of Oklahoma Financial Corporation, SBC Communications Inc. and Kansas City Southern Industries, Inc.

Harry A. Fischer, Jr., 71..... II
 Glenview, Illinois. Director since May 1986. Chairman since January 1988, Chairman, President and Chief Executive Officer from November 1985 to January 1988, and President and Chief Executive Officer from November 1980 to November 1985 of Daubert Industries, Inc., a manufacturer of chemically treated papers, coatings, rust and corrosion prevention chemicals, adhesives, sealants and masking tape products. Formerly a Director of Lee Enterprises, Incorporated.

</TABLE>

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<TABLE>

<CAPTION>

DIRECTOR

CLASS

<S>

<C>

Frank T. MacInnis, 51..... II
 Norwalk, Connecticut. Director since May 1996. Chairman of the Board, President and Chief Executive Officer of EMCOR Group, Inc., one of the world's largest electrical and mechanical construction groups. Formerly Chairman of the Board, President and Chief Executive Officer of Comstock Group, Inc., a nationwide electrical contracting company (1989 -- 1994). Presently Chairman of the Board of ComNet Communications, Inc. and a Director of PORTEC, Inc.

II

Samuel F. Segnar, 70.....
 Houston, Texas. Director since September, 1989. Retired Chairman and Chief Executive Officer of ENRON Corporation; Formerly Chairman of the Board of Collecting Bank, N.A., Houston and Vista Chemical Co. (1986-1988). Presently a

Director of Textron, Inc., Seagull Energy Corporation, Gulf States Utilities Company and serves on the Advisory Board of Pilko & Associates and the National Advisory Board of First Commercial Bank; Owner, Sam F. Segnar Interests, a company involved in construction, development and heavy equipment businesses.

Donald Paul Hodel, 62..... III
Chesapeake, Virginia. Director since September, 1990. Presently President of the Christian Coalition, a grass roots voter education organization and Managing Director of Summit Group International Ltd. and Summit Energy Group, an energy and natural resources consulting firm; Director of Columbia Energy Group.

Malcolm T. Hopkins, 69..... III
Asheville, North Carolina. Director since May 1986. Retired October 1984 as Vice Chairman and Chief Financial Officer, St. Regis Corporation, a diversified, multi-national forest products company, that also had insurance, oil and gas and chemical operations. Presently a private investor and a Director of Columbia Energy Group, Metropolitan Series Fund, Inc., State Street Research and Management Company, EMCOR Group Inc., and U.S. Home Corporation.

Frank A. McPherson, 64..... III
Oklahoma City, Oklahoma. Director since 1997. Served as Chairman of the Board and Chief Executive Officer of Kerr-McGee Corp., from May 1983 until his retirement on February 1997; Presently Director of Tri-Continental Corporation, Seligman Quality Fund, Inc., Seligman Select Municipal Fund, Inc., Seligman Group of Mutual Funds, Kimberly-Clark Corp., and Bank of Oklahoma Financial Corporation; Member of the Board of Trustees of the Oklahoma Nature Conservancy, Southwest Region Board of Trustees of the Boys and Girls Clubs of America and President of the Oklahoma Foundation for Excellence in Education.

John L. Whitmire, 57..... III
Houston, Texas. Director since 1997. Chairman of the Board and Chief Executive Officer of Union Texas Petroleum Holdings, Inc. since January 1996; Executive Vice President -- Worldwide Exploration and Production from January 1994 to January 1996 and Senior Vice President -- Worldwide Exploration and Production from December 1991 to January 1994 for Phillips Petroleum Company; Presently Director of the American Petroleum Institute and the National Audubon Society.

</TABLE>

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(b) Executive Officers of the Registrant

The following tabulation provides information as to each executive officer of MAPCO. Unless otherwise indicated, such persons have held their respective principal occupations stated therein for more than five years.

<TABLE>
<CAPTION>

NAME	AGE	POSITIONS AND OFFICES PRESENTLY HELD WITH REGISTRANT	YEAR FIRST BECAME OFFICER
----	---	-----	-----
<S>	<C>	<C>	<C>
James E. Barnes.....	64	Chairman of the Board, President and Chief Executive Officer	1983
Philip W. Baxter.....	49	Executive Vice President and Chief Financial Officer	1985
Robert G. Sachse.....	50	Executive Vice President and Chief Operating Officer	1993
David W. Bowman.....	57	Senior Vice President, General Counsel and Secretary	1987
Douglas H. Rinke.....	51	Senior Vice President -- Human Resources	1996
Peter A. Fasullo.....	45	Vice President, Business Development and Strategic Planning	1997
Gordon E. Schaechterle, Jr.....	43	Vice President, Controller and Tax Counsel	1994
Donald R. Wellendorf.....	45	Vice President, Treasurer and Investor Relations	1994

</TABLE>

Each of the executive officers named above are elected annually by the directors of MAPCO and serve at the directors' discretion. Each individual named above, other than Mr. Fasullo, has been an officer or employee of MAPCO for at least the past five years. Prior to his employment with MAPCO, from July of 1996 to August of 1997, Mr. Fasullo was Senior Vice-President of Corporate Development of Valero Energy Corp. Prior to that, from October of 1991 to July of 1996, Mr. Fasullo was Senior Vice President of Planning and Development for Valero Natural Gas Company.

There are no family relationships between or among any of the above-named persons or between or among any of the above-named persons and any directors of MAPCO.

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ITEM 11. EXECUTIVE COMPENSATION.

The following table sets forth the total compensation paid or accrued by the Company for services provided during the fiscal years ended December 31, 1997, 1996 and 1995 to the Chief Executive Officer and the four other most highly compensated executive officers and one individual who ceased to be an executive officer of the Company in 1997 but whose compensation would have placed him in this group (the "named Executive Officers").

SUMMARY COMPENSATION TABLE

<TABLE>

<CAPTION>

NAME AND PRINCIPAL POSITION	ANNUAL COMPENSATION			LONG-TERM COMPENSATION AWARDS			
	YEAR	SALARY (\$)	BONUS (\$)	AWARDS			ALL COMPE (\$)
				RESTRICTED STOCK AWARDS (\$)	RESTRICTED STOCK AWARD (\$) (1)	AWARDS SECURITIES UNDERLYING OPTIONS (#) (2)	
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
James E. Barnes	1997	824,167	1,250,000		0	818,409	27,4
Chairman of the Board,	1996	795,000	1,590,000		0	200,000	
President & CEO	1995	795,000	0		0	280,000	
Robert G. Sachse	1997	320,833	347,700		462,500	157,864	7,7
Executive Vice President, COO	1996	260,917	500,000		0	127,812	
	1995	233,000	0		0	68,000	
Philip W. Baxter	1997	280,833	301,340		462,500	161,109	7,4
Executive Vice President, CFO	1996	236,666	450,000		0	150,119	
	1995	188,000	0		0	54,918	
David W. Bowman	1997	253,000	217,960		0	95,839	3,8
Senior Vice President,	1996	249,667	350,000		0	64,618	
General Counsel & Secretary	1995	249,000	0		0	60,000	
Douglas H. Rinke	1997	177,042	155,000		92,500	33,056	2,0
Senior Vice President,	1996	141,333	162,000		0	39,092	
Human Resources	1995	131,500	0		0	11,032	
Jack D. Maynard	1997	232,000	125,000		0	80,205	3,9
Vice President	1996	226,750	300,000		0	64,767	
	1995	209,333	0		0	52,000	

</TABLE>

(1) As a result of significant increases in job responsibilities, restricted

shares were granted to certain key employees including Messrs. Sachse, Baxter and Rinke. The value of the restricted shares was calculated using the composite NYSE closing price on December 31, 1997 of \$46.25. Dividends are paid on restricted shares in the same manner as the Company's issued and outstanding shares. If the merger with Williams is consummated, restricted shares will vest immediately.

- (2) Under the 1989 Stock Incentive Plan, MAPCO has a replacement option feature providing for additional options to restore the potential future appreciation of any outstanding shares actually used to exercise an option, as well as shares forfeited for tax withholding ("Replacement Option"). Replacement Options are granted only in connection with stock-for-stock exchanges where an optionee exercises vested stock options with already owned stock of the Company. The Replacement Option which is received by the optionee is equal to the number of shares used to exercise the original options plus those shares forfeited for tax withholding. Replacement Options have terms substantially similar to the original option, including the same expiration date, except they have an exercise price per share equal to the fair market value of a share of common stock on the date the Replacement Option is granted. Replacement Options are not exercisable for at least six months from the date of grant for those granted prior to January 22, 1992 and twelve months for those granted on and after January 22, 1992. By recapturing the potential for future appreciation through the Replacement Options, key management is provided with the incentive to acquire shares rather than hold options until the end of the exercise period. Replacement Options are granted only to the extent existing shares held by the employee are exchanged to exercise options and accordingly, the total number of options granted never exceeds shareholder approved limits under the

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stock option plans. The CEO has set stock ownership targets for each key member of management including the named Executive Officers. The Replacement Option program has encouraged stock option exercises and helped to increase stock ownership of key management.

- (3) All Other Compensation includes Company matching contributions to the MAPCO Inc. and Subsidiaries Profit Sharing and Savings Plan ("PSSP") and compensation paid to or on behalf of the named Executive Officers participating in the Long-term Investment Savings Plan ("LISP"), a non-qualified defined contribution plan. Company matching contributions to the PSSP for 1997 on behalf of Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard were \$53,891, \$26,915, \$25,406, \$23,469, \$21,075 and \$22,520, respectively. The LISP was terminated and all but a residual amount of the account balances were paid out as compensation to Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard in the amount of \$288,812, \$22,885, \$28,715, \$38,858, \$2,633 and \$50,550, respectively in 1997. In 1998, in

connection with the termination of the LISP, residual account balances were paid as compensation to Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard in the amount of \$17,614, \$955, \$1,532, \$1,644, \$99 and \$2,476, respectively.

- (4) Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard each received lump sum Non-Compete Agreement payments of \$17,380,000, \$5,150,000, \$5,150,000, \$1,625,000, \$860,000, \$1,865,000, respectively. Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard received a lump sum Supplemental Executive Retirement Plan ("SERP") payment of \$3,058,285, \$358,650, \$341,528, \$354,130, \$137,656, \$358,394, respectively. Mr. Barnes also received a lump sum payment of \$2,912,130 representing the benefit accrued through 1997 pursuant to a Supplemental Retirement Agreement ("SRA") as more fully described under the Pension Plan section. Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard received a lump sum vacation benefit payment of \$67,270, \$26,923, \$33,183, \$22,253, \$16,671, \$16,139, respectively. In the event that Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard would not be employed after the potential merger in 1998 with Williams, he would receive a lump sum severance payment of \$3,687,597, \$2,141,245, \$1,915,313, \$1,833,699, \$1,039,668, \$1,618,500, respectively.

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The following table contains information concerning the grant of stock options during fiscal year 1997 to the named Executive Officers.

OPTION GRANTS IN LAST FISCAL YEAR

<TABLE>

<CAPTION>

		INDIVIDUAL GRANTS				
						GRANT DATE VALUE
		NUMBER OF SECURITIES OPTIONS GRANTED (#) (1)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN 1997	PRICE (\$/SHARE)	EXPIRATION DATE (2)	PRESENT VALUE (\$) (3)
NAME						
----		-----	-----	-----	-----	-----
<S>		<C>	<C>	<C>	<C>	<C>
James E. Barnes.....		300,000	8.1%	31.8125	9/22/07	4,540,943
		220,000	5.9%	33.3750	1/27/07	3,558,007
		23,863	0.6%	43.0625	1/23/01	354,381
		22,105	0.6%	43.0625	2/24/99	328,274
		86,139	2.3%	43.0625	1/22/02	1,279,220
		22,618	0.6%	43.0625	2/24/99	335,892
		15,652	0.4%	43.0625	1/30/00	232,442

	28,855	0.8%	43.0625	2/2/03	428,516
	22,034	0.6%	43.0625	2/24/99	327,219
	15,397	0.4%	43.0625	1/30/00	228,655
	22,342	0.6%	43.0625	1/23/01	331,793
	16,167	0.4%	43.0625	1/30/00	240,090
	23,237	0.6%	43.0625	1/23/01	345,085
Robert G. Sachse.....	130,000	3.5%	31.8125	9/22/07	1,967,742
	8,933	0.2%	43.0000	1/22/02	133,823
	5,062	0.1%	43.0000	2/2/03	75,832
	1,989	0.1%	43.0000	2/24/99	29,797
	2,039	0.1%	43.0000	2/24/99	30,546
	3,018	0.1%	43.0000	1/30/00	45,212
	4,157	0.1%	43.0000	1/23/01	62,275
	2,160	0.1%	43.0000	1/23/01	32,358
	121	0.0%	43.0000	2/24/99	1,813
	385	0.0%	33.7500	2/2/03	4,551
Philip W. Baxter.....	130,000	3.5%	31.8125	9/22/07	1,967,742
	5,383	0.1%	43.0000	2/2/03	80,641
	5,255	0.1%	43.0000	1/22/02	78,724
	2,144	0.1%	43.0000	2/24/99	32,119
	2,240	0.1%	43.0000	1/23/01	33,557
	2,630	0.1%	43.0000	1/22/02	39,399
	4,362	0.1%	43.0000	1/23/01	65,346
	3,046	0.1%	43.0000	1/30/00	45,631
	4,349	0.1%	43.0000	2/24/99	65,151
	312	0.0%	43.0000	2/24/99	4,674
	1,388	0.0%	43.0000	1/30/00	20,793
David W. Bowman.....	18,000	0.5%	31.8125	9/22/07	272,456
	35,000	0.9%	33.3750	1/27/07	566,045
	21,733	0.6%	43.7500	1/22/02	327,902
	4,928	0.1%	43.7500	2/24/99	74,352
	6,259	0.2%	43.7500	1/23/01	94,434
	6,146	0.2%	43.7500	1/23/01	92,729
	3,773	0.1%	43.7500	1/30/00	56,926
Douglas H. Rinke.....	17,000	0.5%	31.8125	9/22/07	257,320
	496	0.0%	43.5625	2/24/99	7,451

</TABLE>

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<TABLE>
<CAPTION>

INDIVIDUAL GRANTS

NUMBER OF	% OF TOTAL OPTIONS	GRANT DATE VALUE
-----------	--------------------------	------------------

NAME	SECURITIES OPTIONS GRANTED (#) (1)	GRANTED TO EMPLOYEES IN 1997	PRICE (\$/SHARE)	EXPIRATION DATE (2)	PRESENT VALUE (\$) (3)
<S>	<C>	<C>	<C>	<C>	<C>
	1,625	0.0%	43.5625	1/22/02	24,413
	875	0.0%	43.5625	1/30/00	13,145
	420	0.0%	43.5625	1/23/01	6,310
	1,349	0.0%	32.5000	2/24/99	15,486
	2,233	0.1%	32.5000	2/2/03	25,633
	2,112	0.1%	32.5000	2/24/99	24,244
	770	0.0%	32.5000	2/24/99	8,839
	2,502	0.1%	32.5000	1/30/00	28,721
	3,674	0.1%	32.5000	1/23/01	42,175
Jack D. Maynard.....	15,000	0.4%	31.8125	9/22/07	227,046
	35,000	0.9%	33.3750	1/27/07	566,045
	4,803	0.1%	42.6250	1/23/01	70,603
	2,433	0.1%	42.6250	2/24/99	35,765
	4,930	0.1%	43.0000	1/23/01	73,855
	1,782	0.0%	43.0000	1/30/00	26,696
	1,658	0.0%	43.0000	1/30/00	24,838
	2,357	0.1%	43.0000	2/24/99	35,310
	5,864	0.2%	43.1250	2/2/03	87,962
	6,378	0.2%	43.1250	1/22/02	95,672

</TABLE>

- (1) The number of securities shown in bold faced type and to the left of the Options Granted column for each named Executive Officer denotes original grants made by the Compensation Committee which become exercisable in one-third increments over years two, three and four of the option.
- (2) Original grants made by the Compensation Committee expire ten (10) years from the grant date. Replacement Options have the same expiration date as the original options they have replaced. Replacement Options are denoted by indented lines in the chart. See Footnote 2 under the Summary Compensation Table for additional information regarding Replacement Options.
- (3) In accordance with Securities and Exchange Commission rules, the Black-Scholes option pricing model was chosen to estimate the grant date present value of the options set forth in this table. The Company's use of this model should not be construed as an endorsement of its accuracy at valuing options. All stock option valuation models, including the Black-Scholes model, require a prediction about the future movement of the stock price. The following assumptions were made for purposes of calculating the Grant Date Present Value: for all original grants the option term is assumed to be three years after vesting, interest rates of 6.08% to 6.41%,

volatility of 29.52% calculated by using daily stock prices for the calendar year 1997, and a dividend yield between 1.80% to 1.89% per share. The following assumptions were made for purposes of calculating the Grant Date Present Value for all Replacement Options: the option term is assumed to be three years after vesting, interest rates of 5.71% to 6.16%, volatility of 29.52% calculated by using daily stock prices for the calendar year 1997, and a dividend yield between 1.37% and 1.85% per share. The real value of the options in this table depends upon the actual performance of the Company's stock during the applicable period.

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The following table contains information concerning aggregated stock option exercises during 1997 by the named Executive Officers.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION VALUES

<TABLE>
<CAPTION>

NAME ----	NUMBER OF SECURITIES UNDERLYING OPTIONS EXERCISED(#) (1) -----	VALUE REALIZED(\$) (2) -----	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FY-END (#) EXERCISABLE/ UNEXERCISABLE -----	VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FY-END (\$) (3) EXERCISABLE/ UNEXERCISABLE -----
<S>	<C>	<C>	<C>	<C>
James E. Barnes.....	540,396	7,452,625	50,000/ 1,357,075	987,500/ 17,969,207
Robert G. Sachse.....	51,506	622,803	11,333/ 350,530	223,827/ 5,487,147
Philip W. Baxter.....	44,489	498,846	10,000/ 339,775	197,500/ 5,227,757
David W. Bowman.....	119,378	1,791,325	10,000/ 215,839	197,500/ 3,014,473
Douglas H. Rinke.....	34,616	277,568	0/ 81,722	0/ 1,315,721
Jack D. Maynard.....	77,377	843,253	9,333/ 184,205	184,327/ 2,674,037

</TABLE>

(1) Includes shares forfeited for the named Executive Officer's state and

federal tax withholding obligations and shares tendered in payment of the option exercise prices.

- (2) Includes value of shares forfeited by the named Executive Officer for state and federal tax withholding obligations.
- (3) The value of the unexercised in-the-money options was calculated using the composite NYSE closing price on December 31, 1997 of \$46.25.

PENSION PLAN

The pension plan, in which all eligible employees, including Executive Officers, participate, does not require or permit employees to make contributions. Contributions to the pension plan in respect of any person are not and cannot be separately or individually calculated.

PENSION TABLE -- ANNUAL BENEFIT PAYABLE AT NORMAL RETIREMENT AGE

<TABLE> <CAPTION> AVERAGE ANNUAL COMPENSATION		YEARS OF SERVICE					
		10	15	20	25	30	35
<C>		<C>	<C>	<C>	<C>	<C>	<C>
\$ 100,000		\$ 17,477	\$ 26,215	\$ 34,953	\$ 43,692	\$ 52,430	\$ 61,168
\$ 250,000		46,727	70,090	93,453	116,817	140,180	163,543
\$ 500,000		95,477	143,215	190,953	238,692	286,430	334,168
\$1,000,000		192,977	289,465	385,953	482,442	578,930	675,418
\$1,250,000		241,727	362,590	483,453	604,317	725,180	846,043
\$1,500,000		290,477	435,715	580,953	726,192	871,430	1,016,668
\$1,750,000		339,227	508,840	678,453	848,067	1,017,680	1,187,293
\$2,000,000		387,977	581,965	775,953	969,942	1,163,930	1,357,918

</TABLE>

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The Pension Table above shows approximate total retirement benefits (expressed as an annual straight-life annuity) based on employment with the Company for an employee covered by the qualified and non-qualified retirement plans. "Average annual compensation" is determined with reference to the base salary and bonus compensation of the named Executive Officers disclosed in the Summary Compensation Table above, except as described below for Mr. Barnes. Average annual compensation levels are the average base salary and bonus compensation for the three highest consecutive years of the 10 years immediately before retirement date. The normal retirement date is at age 65, 66 or 67, depending upon the participant's birth year. The benefit amounts listed in the

table are not subject to reduction for Social Security benefits or on any other basis except as noted below.

At December 31, 1997, Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard, were credited with 14.58, 15.93, 18.18, 10.72, 17.41 and 16.83 years of service, respectively. In addition, Mr. Barnes is, pursuant to a separate retirement agreement, credited with additional service equal to service earned with his prior employer (26 years). Such service is applied with reference to a modified base salary and bonus compensation at the Company which reflects only 50% of his promotion pay increases and bonus compensation. This additional retirement benefit is reduced by the retirement benefit earned by Mr. Barnes at his prior employer.

EMPLOYMENT CONTINUATION AGREEMENTS

The Company has entered into Employment Continuation Agreements (the "Agreements") with seven (7) of its Executive Officers (the "Officers"), including Messrs. Barnes, Sachse, Baxter, Bowman, Rinke and Maynard, which were amended in November, 1997.

Agreements similar to the Agreements have been in effect since prior to December 31, 1989. The Agreements were generally automatically extended on January 1, 1998, and will continue to automatically extend each January 1 thereafter unless, not later than October 1 of the preceding year, the Company shall have given notice that it does not wish to extend the Agreement and provided that if a Change in Control (as defined below) occurs, the Agreements shall automatically continue for twenty-four months beyond the month in which such Change in Control occurred. Under each Agreement, the Officer is obligated to remain in the Company's employ for the earliest of (a) nine months following the occurrence of a Potential Change in Control, (b) the date of a Change in Control, (c) the date the Officer terminates his employment by reason of Death, Disability or Retirement, or (d) the termination by the Company of the Officer's employment. The proposed merger between the Company and Williams will constitute a Change of Control for purposes of the Agreements.

For purposes of the Agreements, a "Change in Control" shall be deemed to have occurred if (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportion as their ownership of stock of the Company), is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 25% or more of the combined voting power of the Company's then outstanding securities eligible to vote; or (ii) during any period of two consecutive years (not including any period prior to the execution of the Agreement), individuals who at the beginning of such period constitute the Board, and any new director (other than

a director designated by a person who has entered into an agreement with the Company to effect a transaction described in clause (i), (ii) or (iv) of this Paragraph) whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved (hereinafter referred to as "Continuing Directors"), cease for any reason to constitute at least a majority thereof; or (iii) the stockholders of the Company approve a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into

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voting securities of the surviving entity) in combination with the ownership of any trustee or other fiduciary holding securities under an employee benefit plan of the Company, more than 75% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; provided, however, that a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the Company's then outstanding securities shall not constitute a Change in Control of the Company; or (iv) the stockholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets (or any transaction having a similar effect).

For purposes of the Agreements, a "Potential Change in Control" shall be deemed to have occurred if (i) the Company enters into an agreement, the consummation of which would result in the occurrence of a Change in Control; (ii) any person (including the Company) publicly announces an intention to take or to consider taking actions which if consummated would constitute a Change in Control; or (iii) any person other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company (or a corporation owned, directly or indirectly by the stockholders of the Company in substantially the same proportion as their ownership of stock of the Company), who is or becomes the beneficial owner, directly or indirectly, of securities of the corporation representing 10% or more of the combined voting power of the Company's then outstanding securities, increases such person's beneficial ownership of such securities by 5% or more over the percentage so owned by such person on the date hereof; or (iv) the Board of Directors of the Company adopts a resolution to the effect that, for purposes of the Agreement, a Potential Change in Control has occurred.

If, within three (3) years following a Change in Control, an Officer's

employment is terminated by the Company (other than for cause, as defined in the Agreements, or on account of the Officer's Death, or Disability) or by the Officer for other than Good Reason as defined in the Agreement, the Company will pay the Officer a single sum severance payment equal to the product of a specified multiple of the sum of (i) the Officer's then current annual salary, plus (ii) the highest annual incentive compensation payment for the current calendar year or any of the last three (3) years, plus (iii) awards paid under the Company's Performance Bonus Plan or any successor thereto. The multiple ranges from one and one-half times (in the case of Mr. Barnes) to three times in the case of other Officers (including Mr. Bowman and Mr. Rinke).

In addition, for a period equivalent to the period for which severance is payable (e.g., eighteen months for Mr. Barnes, thirty months for Messrs. Baxter and Sachse, and thirty-six months for Messrs. Bowman and Rinke), the Company shall provide the Officer with benefits substantially similar to those which the Officer was receiving or entitled to receive under the Company's life, disability, accident and group health insurance plans or any similar plans in which the Officer was participating immediately prior to the date of termination at a cost to the Officer which is no greater than that cost to the Officer in effect at the date of termination.

The Company has also agreed to pay the Officer an additional amount ("Gross-Up Payment") such that the net amount retained by the Officer upon the payments provided under the Agreement, after deduction of federal, state and local income tax and any tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended, shall be equal to the Severance Payment. The Company has also agreed to pay all reasonable and appropriate legal fees and expenses incurred by the Officer as a result of the Officer's qualifying termination (including all such fees and expenses, if any, reasonably incurred in contesting or disputing by arbitration or otherwise, any such termination or in seeking to obtain or enforce any right or benefit provided by the Agreement or in connection with any tax audit or proceeding to the extent attributable to the application of Section 4999 of the Internal Revenue Code of 1986, as amended, (the "Code"), to any payment or benefit provided under the Agreement).

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COMPENSATION OF THE BOARD

Employee directors are not compensated for services as a director. Non-employee directors ("Outside Directors") receive an annual retainer of \$25,000 and, with the exception of director Donald L. Mellish, a fee of \$1,000 for attendance at each Board or Committee meeting. Because Mr. Mellish routinely travels to Board or Committee meetings from outside the contiguous 48 states, he receives double the Board or Committee meeting attendance fee of \$1,000; provided, however, if the Board and Committee meetings are held jointly, only his Board attendance fee is doubled. The Audit and Compensation Committee

Chairmen receive additional annual compensation of \$4,000 and the Governance and Finance Committee Chairmen receive annual compensation of \$3,000 in addition to Committee attendance fees. The Company also reimburses its Directors for travel, lodging and related expenses incurred in attending Board and Committee meetings and provides each Outside Director with \$100,000 in life insurance benefits and \$250,000 in accidental death and dismemberment insurance benefits.

Outside Directors whose service began prior to January 1, 1996 are eligible to participate in the 1986 Retirement Plan for Non-Employee Directors (the "Director Retirement Plan"). Under the Director Retirement Plan, an Outside Director who has completed at least five years of service as a member of the Board of Directors and retires from the Board after attaining age 70 will receive a benefit for life equal to the annual retainer fee payable to an Outside Director at the time of his retirement. An Outside Director who has not attained age 70 at the time he leaves the Board, but who has completed at least five years of service as a member of the Board, will generally receive a benefit equal to the annual retainer fee then payable to an Outside Director for the lesser of (i) the number of years during which the Outside Director served as a member of the Board or (ii) ten years. Upon the occurrence of a Change in Control (as defined in the Employment Continuation Agreements for executive officers described above), all Outside Directors will be entitled to receive a benefit under such plan, regardless of the length of Board membership. Such benefit will be equal to the annual retainer fee then payable to an Outside Director during his lifetime for a period equal to the greater of (i) the number of years during which the Outside Director served as a member of the Board or (ii) ten years.

Each Outside Director will receive an immediately exercisable option having a ten-year term to purchase 2,000 shares of the Company's common stock on the later of the first business day following the annual meeting of the Company's Stockholders or June 1 and shall have an option price equal to the fair market value of a share of the Company's common stock on the date of grant. Such options were granted to all Outside Directors then in office at the date of the annual meeting of shareholders in 1997, but no such options will be granted if the Williams Merger is consummated.

In January 1996, the Company adopted the MAPCO Inc. Outside Director Phantom Stock Plan (the "Phantom Plan"), effective as of January 1, 1996. All Outside Directors are eligible to participate in the Phantom Plan. Under the Phantom Plan, on June 1 of each year, each Outside Director of the Company will receive "phantom" shares of the Company's common stock ("Phantom Stock") equal to one-half of the amount of the then current Annual Retainer. In addition, an Outside Director may elect to have all or a part of the Annual Retainer Fee payable by the Company converted to Phantom Stock. The shares held as Phantom Stock are adjusted for cash dividends, stock dividends, stock splits, mergers and other changes in capitalization of the Company.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

(a) Common Stock Ownership of Directors and Executive Officers

The following table shows information concerning beneficial ownership of the Company's common stock by all Directors and by the Company's Chief Executive Officer, each of the Company's four other most highly compensated executive officers for 1997 (the "named Executive Officers") and all Directors and Executive Officers as a group. In 1994, the Board reviewed the policy-making functions of the Company's officers and redefined which officers would be included as Executive Officers (those officers with reporting responsibilities under Section 16 of the Securities and Exchange Act of 1934, as amended). As a result of this and subsequent reviews, the Board has specifically designated the Chairman, all Executive Vice Presidents, all Senior Vice

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Presidents, the Vice President, Business Development and Strategic Planning, the Vice President, Controller and Tax Counsel, and the Vice President, Treasurer and Investor Relations of the Company as Executive Officers. The persons named below have sole voting and investment power with respect to all shares of common stock owned by them, unless otherwise noted.

<TABLE>
<CAPTION>

DIRECTOR OR NAMED EXECUTIVE OFFICER -----	NUMBER OF SHARES OF COMMON STOCK BENEFICIALLY OWNED DIRECTLY OR INDIRECTLY ON FEBRUARY 16, 1998 -----	PERCENT OF CLASS -----
<S>	<C>	<C>
Donald L. Mellish.....	47,000 (3)	(1)
Robert L. Parker.....	32,800 (3)	(1)
James E. Barnes.....	685,491 (2)	1.6%
Harry A. Fischer, Jr.....	32,000 (3)	(1)
Frank T. MacInnis.....	5,000 (3)	(1)
Samuel F. Segnar.....	30,000 (3)	(1)
Malcolm T. Hopkins.....	35,500 (3)	(1)
Donald Paul Hodel.....	24,200 (3) (4)	(1)
Frank A. McPherson.....	2,000	(1)
John L. Whitmire.....	2,000	(1)
Robert G. Sachse.....	66,951 (2)	(1)
Philip W. Baxter.....	70,287 (2)	(1)
David W. Bowman.....	143,604 (2)	(1)
Douglas H. Rinke.....	34,489 (2)	(1)
Jack D. Maynard.....	58,432 (2)	(1)
	-----	---

All Directors and Executive Officers as a group (18)

persons) 1,331,095 (2) (3) 2.7%

</TABLE>

(1) Does not exceed one percent.

(2) Includes options for the Company's common stock that may be exercised within 60 days by Messrs. Barnes (132,667), Sachse (27,051), Baxter (14,667), Bowman (30,000), Maynard, (25,333), Rinke (5,067) and by all Executive Officers and Directors as a group (428,271), excluding any options that will become exercisable upon shareholder approval of the Williams Merger. Also includes shares of the Company's Common Stock that are allocated as of December 31, 1997 under the MAPCO Inc. & Subsidiaries Profit Sharing and Savings Plan (Mr. Barnes 5,097 shares, Mr. Sachse 4,271 shares, Mr. Baxter 4,312 shares, Mr. Bowman 9,955 shares, Mr. Maynard 4,521 shares, and Mr. Rinke 3,649 shares).

(3) Includes options for the Company's common stock that may be exercised within 60 days by all non-employee Directors under the 1989 Outside Directors Stock Option Plan and includes shares held in the dividend reinvestment plan of MAPCO Inc. Fractional shares held in the dividend reinvestment plan have been rounded.

(4) Includes 200 shares held by spouse.

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(b) Other Ownership of MAPCO Common Stock

According to information from Schedule 13G filings as of February 18, 1998, the following table lists the Stockholders known to the Company to be beneficial holders of more than five percent of the outstanding common stock of the Company:

<TABLE>

<CAPTION>

NAME & ADDRESS OF BENEFICIAL OWNER -----	AMOUNT & NATURE OF BENEFICIAL OWNERSHIP -----	PERCENT OF CLASS -----
<S> Sanford C. Bernstein & Co. Inc..... 0	<C> 5,247,659 (1)	<C> 9.6%

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FORWARD-LOOKING STATEMENTS

Statements in this Quarterly Report on Form 10-Q, including those contained in the foregoing discussion and other items herein, concerning the Company which are (a) projections of revenues, earnings, earnings per share, capital expenditures or other financial items, (b) statements of plans and objectives for future operations, (c) statements of future economic performance, or (d) statements of assumptions or estimates underlying or supporting the foregoing are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The ultimate accuracy of forward-looking statements is subject to a wide range of business risks and changes in circumstances, and actual results and outcomes often differ from expectations. Any number of important factors could cause actual results to differ materially from those in the forward-looking statements herein, including the following: the timing and extent of changes in commodity prices and underlying demand and availability of crude oil and other refinery feedstocks, refined products, and natural gas; actions of our customers and competitors; changes in the cost or availability of third-party vessels, pipelines and other means of transporting feedstocks and products; state and federal environmental, economic, safety and other policies and regulations, any changes therein, and any legal or regulatory delays or other factors beyond the Company's control; execution of planned capital projects; weather conditions affecting the Company's operations or the areas in which the Company's products are marketed; future well performance; the extent of Tesoro's success in acquiring oil and gas properties and in discovering, developing and producing reserves; political developments in foreign countries; the conditions of the capital markets and equity markets during the periods covered by the forward-looking statements; earthquakes or other natural disasters affecting operations; adverse rulings, judgments, or settlements in litigation or other legal matters, including unexpected environmental remediation costs in excess of any reserves; and adverse changes in the credit ratings assigned to the Company's trade credit. For more information with respect to the foregoing, see the Company's Annual Report on Form 10-K. The Company undertakes no obligation to publicly release the result of any revisions to any such forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As previously reported, on June 21, 1997, the Company received a letter from the Office of the Attorney General of the State of Alaska ("State")

alleging that Kenai Pipe Line Company ("KPL"), a wholly-owned subsidiary of the Company, failed to follow the terms of its Oil Discharge Prevention and Contingency Plan ("Contingency Plan"), which allegation arose out of the State's investigation of a December 5, 1995 spill into the Cook Inlet from KPL's facility. The Company has settled all claims with the State by agreeing to (i) pay \$70,000 to the State as a civil penalty and to reimburse the State for its costs; (ii) contribute \$10,000 to the Cook Inlet Regional Citizens Advisory Council to conduct additional operational oversight of KPL's Contingency Plan; and (iii) complete a pollution prevention project at KPL's facility with an estimated cost of \$50,000 by December 31, 1998.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

See the Exhibit Index immediately preceding the exhibits filed herewith.

(b) Reports on Form 8-K

No reports on Form 8-K have been filed during the quarter for which this report is filed.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TESORO PETROLEUM CORPORATION
REGISTRANT

Date: November 14, 1997

/s/

BRUCE A. SMITH
Bruce A. Smith
Chairman of the Board of Directors,
President and Chief Executive Officer

Date: November 14, 1997

/s/

DON E. BEERE
Don E. Beere
Vice President, Controller
(Chief Accounting Officer)

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EXHIBIT INDEX

EXHIBIT
NUMBER

- 4.1 First Amendment to Amended and Restated Credit Agreement ("Credit Facility") among the Company and Banque Paribas, individually, as an Issuing Bank and as Administrative Agent ("Banque Paribas"), The Bank of Nova Scotia, individually and as Documentation Agent ("Bank of Nova Scotia"), and other financial institution parties thereto, effective as of March 21, 1997.
- 4.2 Second Amendment to Credit Facility among the Company, Banque Paribas, Bank of Nova Scotia and other financial institution parties thereto, effective as of March 31, 1997.
- 4.3 Third Amendment to Credit Facility among the Company, Banque Paribas, Bank of Nova Scotia and other financial institution parties thereto, effective as of September 15, 1997.
- 27 Financial Data Schedule.

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</TEXT>
</DOCUMENT>
<DOCUMENT>
<TYPE>EX-4.1
<SEQUENCE>2
<DESCRIPTION>FIRST AMENDMENT TO CREDIT AGREEMENT
<TEXT>

FIRST AMENDMENT TO
AMENDED AND RESTATED CREDIT AGREEMENT

Among

TESORO PETROLEUM CORPORATION
as the Company

and

BANQUE PARIBAS
Individually, as an Issuing Bank and as Administrative Agent,

THE BANK OF NOVA SCOTIA
Individually and as Documentation Agent

and

THE FINANCIAL INSTITUTIONS
NOW OR HEREAFTER PARTIES HERETO

Effective as of March 21, 1997

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FIRST AMENDMENT AND SUPPLEMENT TO
CREDIT AGREEMENT

This FIRST AMENDMENT AND SUPPLEMENT TO CREDIT AGREEMENT (this "First Amendment") executed effective as of March 21, 1997 (the "Effective Date"), is by and among TESORO PETROLEUM CORPORATION, a Delaware corporation (the "Company"); BANQUE PARIBAS, individually, as an Issuing Bank and as Administrative Agent, THE BANK OF NOVA SCOTIA, individually and as Documentation Agent, and each of the lenders that is a signatory hereto or which becomes a party hereto as provided in Section 9.07 (individually, a "Lender" and, collectively, the "Lenders").

W I T N E S S E T H:

WHEREAS, the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders are parties to that certain Amended and Restated Credit Agreement dated as of June 7, 1996 (the "Credit Agreement"), pursuant to which the Lenders agreed to make loans and issue Letters of Credit to and for the account of the Company; and

WHEREAS, the Company, the Guarantors, the Administrative Agent, the Documentation Agent, and the Lenders desire to amend the Credit Agreement in the particulars hereinafter provided;

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties hereto agree as follows:

ARTICLE I. DEFINITIONS

Section 1.01 Terms Defined Above. As used in this First Amendment, each of the terms "Company", "Credit Agreement", "Effective Date", "First Amendment", and "Lenders" shall have the meaning assigned to such term hereinabove.

Section 1.02 Terms Defined in Credit Agreement. Each term defined in the Credit Agreement and used herein without definition shall have the meaning assigned to such term in the Credit Agreement, unless expressly provided to the contrary.

Section 1.03 Other Definitional Provisions.

(a) The words "hereby", "herein", "hereinafter", "hereof", "hereto" and "hereunder" when used in this First Amendment shall refer to this First Amendment as a whole and not to any particular Article, Section, subsection or provision of this First Amendment.

(b) Section, subsection and Exhibit references herein are to such Sections, subsections and Exhibits to this First Amendment unless otherwise specified.

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ARTICLE II. AMENDMENTS TO CREDIT AGREEMENT

The Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders agree that the Credit Agreement is hereby amended, effective as of the Effective Date, in the following particulars.

Section 2.01 Amendments and Supplements to Definitions.

(a) The definition of "Agreement" in Section 1.01 of the Credit Agreement is hereby amended to mean the Credit Agreement, as amended by this First Amendment and as the same may from time to time be further amended, supplemented or modified.

(b) Section 1.01 of the Credit Agreement is hereby further amended and supplemented by adding the following new definition where alphabetically appropriate, which read in their entirety as follows:

"First Amendment" shall mean that certain First Amendment to Amended and Restated Credit Agreement dated as of March 21, 1997, by and among the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders.

Section 2.02 Amendments to Article VI. Section 6.09(e) of the Credit Agreement is hereby amended in its entirety to read as follows:

"(e) routine loans or advances to employees made in the ordinary course of business not to exceed (A) \$1,500,000 at any one time outstanding to any one employee and (B) \$5,000,000 in the aggregate;"

ARTICLE III. CONDITIONS

The enforceability of this First Amendment against the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders is subject to the satisfaction of the following conditions precedent:

Section 3.01 Loan Documents. The Administrative Agent shall have received multiple original counterparts, as requested by the Administrative Agent, of this First Amendment executed and delivered by a duly authorized officer of the Company, each of the Guarantors, the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender, as applicable;

Section 3.02 Corporate Proceedings of Loan Parties. The Administrative Agent shall have received multiple copies, as requested by the Administrative Agent, of the resolutions, in form and substance reasonably satisfactory to the Administrative Agent, of the Boards of Directors of the

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Company and the Guarantors, authorizing the execution, delivery and performance of this First Amendment, each such copy being attached to an original certificate of the Secretary or an Assistant Secretary of the Company or the Guarantors, as applicable, dated as of the Effective Date, certifying (i) that the resolutions attached thereto are true, correct and complete copies of resolutions duly adopted by written consents or at meetings of the Boards of Directors, (ii) that such resolutions constitute all resolutions adopted with respect to the transactions contemplated hereby, (iii) that such resolutions have not been amended, modified, revoked or rescinded as of the Effective Date, (iv) that the respective articles of incorporation and bylaws of the Company and the Guarantors have not been amended or otherwise modified since the effective date of the Credit Agreement, except pursuant to any amendments attached thereto, and (v) as to the incumbency and signature of the officers of the Company or the Guarantors, as applicable, executing this First Amendment.

Section 3.03 Representations and Warranties. Except as affected by the transactions contemplated in the Credit Agreement and this First Amendment, each of the representations and warranties made by the Company and the Guarantors in or pursuant to the Financing Documents, including the Credit Agreement, shall be true and correct in all material respects as of the Effective Date, as if made on and as of such date.

Section 3.04 No Default. No Default or Event of Default shall have occurred and be continuing as of the Effective Date.

Section 3.05 Security Instruments. All of the Security Instruments (subject to any partial releases thereof) shall be in full force and effect and provide to the Administrative Agent the security intended thereby to secure the Indebtedness.

Section 3.06 Other Instruments or Documents. The Administrative Agent or any Lender or counsel to the Administrative Agent shall receive such other instruments or documents as they may reasonably request.

ARTICLE IV. MISCELLANEOUS

Section 4.01 Adoption, Ratification and Confirmation of Credit Agreement. Each of the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders does hereby adopt, ratify and confirm the Credit Agreement, as amended hereby, and acknowledges and agrees that the Credit Agreement, as amended hereby, is and remains in full force and effect.

Section 4.02 Ratification and Affirmation of Guaranty. Each of the Guarantors hereby expressly (i) acknowledges the terms of this First Amendment, (ii) ratifies and affirms its obligations under the Second Amended and Restated Guaranty Agreement dated as of January 28, 1997, in favor of the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders, as amended, supplemented or otherwise modified ("Guaranty Agreement"), (iii) acknowledges, renews and extends its continued liability under the Guaranty Agreement and agrees that such Guaranty

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Agreement remains in full force and effect; and (iv) guarantees to the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender to promptly pay when due all amounts owing or to be owing by it under the Guaranty Agreement pursuant to the terms and conditions thereof.

Section 4.03 Successors and Assigns. This First Amendment shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns permitted pursuant to the Credit Agreement.

Section 4.04 Counterparts. This First Amendment may be executed by one or more of the parties hereto in any number of separate counterparts, and all of such counterparts taken together shall be deemed to constitute one and the same instrument and shall be enforceable as of the Effective Date upon the execution of one or more counterparts hereof by the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders. In this regard, each of the parties hereto acknowledges that a counterpart of this First Amendment containing a set of counterpart execution pages reflecting the execution of each party hereto shall be sufficient to reflect the execution

of this First Amendment by each necessary party hereto and shall constitute one instrument.

Section 4.05 Number and Gender. Whenever the context requires, reference herein made to the single number shall be understood to include the plural; and likewise, the plural shall be understood to include the singular. Words denoting sex shall be construed to include the masculine, feminine and neuter, when such construction is appropriate; and specific enumeration shall not exclude the general but shall be construed as cumulative. Definitions of terms defined in the singular or plural shall be equally applicable to the plural or singular, as the case may be, unless otherwise indicated.

Section 4.06 Entire Agreement. This First Amendment constitutes the entire agreement among the parties hereto with respect to the subject hereof. All prior understandings, statements and agreements, whether written or oral, relating to the subject hereof are superseded by this First Amendment.

Section 4.07 Invalidity. In the event that any one or more of the provisions contained in this First Amendment shall for any reason be held invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this First Amendment.

Section 4.08 Titles of Articles, Sections and Subsections. All titles or headings to Articles, Sections, subsections or other divisions of this First Amendment or the exhibits hereto, if any, are only for the convenience of the parties and shall not be construed to have any effect or meaning with respect to the other content of such Articles, Sections, subsections, other divisions or exhibits, such other content being controlling as the agreement among the parties hereto.

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Section 4.09 Governing Law. This First Amendment and the rights and obligations of the parties hereunder and under the Credit Agreement shall be governed by and construed in accordance with the laws of the State of Texas and the United States of America.

THIS FIRST AMENDMENT, THE CREDIT AGREEMENT, AS AMENDED AND SUPPLEMENTED HEREBY, THE NOTES, AND THE OTHER FINANCING DOCUMENTS CONSTITUTE A WRITTEN LOAN AGREEMENT AND REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

[SIGNATURES BEGIN NEXT PAGE]

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IN WITNESS WHEREOF, the parties hereto have caused this First Amendment to be duly executed and delivered by their proper and duly authorized officers as of the Effective Date.

COMPANY:

TESORO PETROLEUM CORPORATION

By: /s/ G. A. Wright
Name: G. A. Wright
Title: Vice President and Treasurer

ADMINISTRATIVE AGENT,
ISSUING BANK AND LENDER:

BANQUE PARIBAS, individually, as an Issuing
Bank and as Administrative Agent

By: /s/ B. Malone
Name: Brian Malone
Title: Vice President

By: /s/ Barton D. Schouest
Name: Barton D. Schouest
Title: Group Vice President

DOCUMENTATION AGENT,
ISSUING BANK AND LENDER:

THE BANK OF NOVA SCOTIA

By: /s/ F.C.H. Ashby
Name: F.C.H. Ashby
Title: Senior Manager
Loan Operations

LENDERS:

BANK OF SCOTLAND

By: /s/ Annie Chin Tat
Name: Annie Chin Tat
Title: Assistant Vice President

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CHRISTIANIA BANK OG KREDITKASSE

By: /s/ Williams S. Phillips
Name: Williams S. Phillips
Title: Vice President

By: /s/ Peter M. Dodge
Name: Peter M. Dodge
Title: First Vice President

THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as an Issuing Bank

By: /s/ George R. Schanz
Name: George R. Schanz
Title: Vice President

FIRST UNION NATIONAL BANK OF NORTH
CAROLINA

By: /s/ Michael J. Kolosowsky
Name: Michael J. Kolosowsky
Title: Vice President

NATIONAL BANK OF CANADA

By: /s/ Larry L. Sears
Name: Larry L. Sears
Title: Group Vice President

By: /s/ Doug G. Clark
Name: Doug G. Clark
Title: Vice President

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THE FROST NATIONAL BANK

By: /s/ Jennifer A. Crabtree
Name: Jennifer A. Crabtree
Title: Associate Relationship Manager

DEN NORSKE BANK ASA

By: /s/ Morten Bjornsen
Name: Morten Bjornsen
Title: Senior Vice President

By: /s/ J. Morten Kreutz
Name: J. Morten Kreutz
Title: Vice President

GUARANTORS:

TESORO ALASKA PETROLEUM COMPANY
TESORO EXPLORATION AND PRODUCTION
COMPANY
TESORO PETROLEUM COMPANIES, INC.
DIGICOMP, INC.
TESORO TECHNOLOGY PARTNERS COMPANY
INTERIOR FUELS COMPANY
TESORO ALASKA PIPELINE COMPANY
TESORO NORTHSTORE COMPANY
TESORO REFINING, MARKETING & SUPPLY
COMPANY
TESORO NATURAL GAS COMPANY
TESORO BOLIVIA PETROLEUM COMPANY
TESORO VOSTOK COMPANY
KENAI PIPE LINE COMPANY
TESORO MARINE SERVICES COMPANY
TESORO COASTWIDE SERVICES COMPANY
COASTWIDE MARINE SERVICES, INC.

By: /s/ G. A. Wright
Name: G. A. Wright
Title: Vice President and Treasurer

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TESORO GAS RESOURCES COMPANY, INC.
TESORO FINANCIAL SERVICES HOLDING COMPANY

By: /s/ J. B. Fabian
Name: J. B. Fabian
Title: President

VICTORY FINANCE COMPANY

By: /s/ David W. Dupert
Name: David W. Dupert
Title: President

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TESORO E&P COMPANY, L.P.

By: TESORO EXPLORATION AND PRODUCTION
COMPANY, as its general partner

By: /s/ G. A. Wright
G. A. Wright
Vice President and Treasurer

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<TYPE>EX-4.2

<SEQUENCE>3

<DESCRIPTION>SECOND AMENDMENT TO CREDIT AGREEMENT

<TEXT>

SECOND AMENDMENT TO
AMENDED AND RESTATED CREDIT AGREEMENT

Among

TESORO PETROLEUM CORPORATION

as the Company

and

BANQUE PARIBAS

Individually, as an Issuing Bank and as Administrative Agent,

THE BANK OF NOVA SCOTIA

Individually and as Documentation Agent

and

THE FINANCIAL INSTITUTIONS
NOW OR HEREAFTER PARTIES HERETO

Effective as of March 31, 1997

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SECOND AMENDMENT AND SUPPLEMENT TO
CREDIT AGREEMENT

This SECOND AMENDMENT AND SUPPLEMENT TO CREDIT AGREEMENT (the "Second Amendment") executed effective as of March 31, 1997 (the "Effective Date"), is by and among TESORO PETROLEUM CORPORATION, a Delaware corporation (the "Company"); BANQUE PARIBAS, individually, as an Issuing Bank and as Administrative Agent, THE BANK OF NOVA SCOTIA, individually and as Documentation Agent, and each of the lenders that is a signatory hereto or which becomes a party hereto as provided in Section 9.07 (individually, a "Lender" and, collectively, the "Lenders").

W I T N E S S E T H:

WHEREAS, the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders are parties to that certain Amended and Restated Credit Agreement dated as of June 7, 1996, as amended by First Amendment to Amended and Restated Credit Agreement dated as of March 21, 1997 (the "Credit Agreement"), pursuant to which the Lenders agreed to make loans and issue Letters of Credit to and for the account of the Company; and

WHEREAS, the Company, the Guarantors, the Administrative Agent, the Documentation Agent, and the Lenders desire to amend the Credit Agreement in the particulars hereinafter provided;

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties hereto agree as follows:

ARTICLE I. DEFINITIONS

Section 1.01 Terms Defined Above. As used in this Second Amendment, each of the terms "Company", "Credit Agreement", "Effective Date", "Second

Amendment", and "Lenders" shall have the meaning assigned to such term hereinabove.

Section 1.02 Terms Defined in Credit Agreement. Each term defined in the Credit Agreement and used herein without definition shall have the meaning assigned to such term in the Credit Agreement, unless expressly provided to the contrary.

Section 1.03 Other Definitional Provisions.

(a) The words "hereby", "herein", "hereinafter", "hereof", "hereto" and "hereunder" when used in this Second Amendment shall refer to this Second Amendment as a whole and not to any particular Article, Section, subsection or provision of this Second Amendment.

(b) Section, subsection and Exhibit references herein are to such Sections, subsections and Exhibits to this Second Amendment unless otherwise specified.

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ARTICLE II. AMENDMENTS TO CREDIT AGREEMENT

The Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders agree that the Credit Agreement is hereby amended, effective as of the Effective Date, in the following particulars.

Section 2.01 Amendments and Supplements to Definitions.

(a) The definition of "Agreement" in Section 1.01 of the Credit Agreement is hereby amended to mean the Credit Agreement, as amended by this Second Amendment and as the same may from time to time be further amended, supplemented or modified.

(b) Section 1.01 of the Credit Agreement is hereby further amended and supplemented by adding the following new definition where alphabetically appropriate, which reads in its entirety as follows:

"Second Amendment" shall mean that certain Second Amendment to Amended and Restated Credit Agreement dated as of March 31, 1997, by and among the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders.

Section 2.02 Amendments to Article V. Section 5.15(e) of the Credit Agreement is hereby amended in its entirety to read as follows:

"(e) Engineering Reports. Promptly after December 31st and June 30th

of each year, but in no event later than 60 days after such date, a report (the "Reserve Report") in form and substance satisfactory to the Majority Lenders, and in the case of the December 31 Reserve Report, prepared by the engineering staff of the Company and audited by Netherland, Sewell & Associates or other independent petroleum consultant(s) acceptable to the Majority Lenders (the previous acceptability of an independent petroleum consultant satisfactory to the Majority Lenders shall have no bearing on such consultant's present or future acceptability), which Reserve Report shall evaluate the Hydrocarbon reserves included in the Mortgaged Property as of each such date and which shall, together with any other information reasonably requested by any Lender, set forth the total Proved Hydrocarbon reserves by accepted and customary reserve category attributable to such Mortgaged Property, together with a projection of the rate of production and future net income with respect thereto as of each such date. The June 30 Reserve Report shall be an unaudited Reserve Report prepared by the engineering staff of the Company and shall update the most recent Reserve Report. Notwithstanding the foregoing, (i) if the Company or any of its Subsidiaries acquires additional Oil and Gas Properties that, in the determination of the Majority Lenders, materially affects

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the E&P Borrowing Base, then the Majority Lenders may require that an initial Reserve Report relating to such newly acquired Oil and Gas Properties be prepared by Netherland, Sewell & Associates or other independent petroleum consultants acceptable to the Majority Lenders, to be delivered to the Lenders concurrently with the next required Reserve Report and (ii) if there is a material adverse effect on Tesoro LP because of a change in the value of the Hydrocarbon reserves included in the determination of the E&P Borrowing Base (other than solely as the result of a change in the price of natural gas), then the Majority Lenders may require that a Reserve Report relating to all of the Oil and Gas Properties included in the determination of the E&P Borrowing Base be prepared by Netherland, Sewell & Associates or other independent petroleum consultants acceptable to the Majority Lenders, to be delivered within 60 days after the request therefor by the Administrative Agent on behalf of the Majority Lenders."

Section 2.03 Amendments to Article VI.

(a) Section 6.05(n) of the Credit Agreement is hereby amended in its entirety to read as follows:

"(n) Indebtedness, not to exceed \$18,000,000 in the aggregate, incurred by Tesoro Northshore or Tesoro Alaska, to be used for (i) the purchase (in fee or leasehold), construction, and/or upgrading of retail outlet stores or (ii) modifications to the hydrocracker located at the Kenai

Refinery, subject, however, to the execution of an intercreditor agreement satisfactory in form and substance to the Administrative Agent and Documentation Agent."

(b) Section 6.06(p) of the Credit Agreement is hereby amended in its entirety to read as follows:

"(p) Liens securing up to \$18,000,000 of Indebtedness permitted by Section 6.05(n);"

ARTICLE III. CONDITIONS

The enforceability of this Second Amendment against the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders is subject to the satisfaction of the following conditions precedent:

Section 3.01 Loan Documents. The Administrative Agent shall have received multiple original counterparts, as requested by the Administrative Agent, of this Second Amendment executed and delivered by a duly authorized officer of the Company, each of the Guarantors, the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender, as applicable;

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Section 3.02 Corporate Proceedings of Loan Parties. The Administrative Agent shall have received multiple copies, as requested by the Administrative Agent, of the resolutions, in form and substance reasonably satisfactory to the Administrative Agent, of the Boards of Directors of the Company and the Guarantors, authorizing the execution, delivery and performance of this Second Amendment, each such copy being attached to an original certificate of the Secretary or an Assistant Secretary of the Company or the Guarantors, as applicable, dated as of the Effective Date, certifying (i) that the resolutions attached thereto are true, correct and complete copies of resolutions duly adopted by written consents or at meetings of the Boards of Directors, (ii) that such resolutions constitute all resolutions adopted with respect to the transactions contemplated hereby, (iii) that such resolutions have not been amended, modified, revoked or rescinded as of the Effective Date, (iv) that the respective articles of incorporation and bylaws of the Company and the Guarantors have not been amended or otherwise modified since the effective date of the Credit Agreement, except pursuant to any amendments attached thereto, and (v) as to the incumbency and signature of the officers of the Company or the Guarantors, as applicable, executing this Second Amendment.

Section 3.03 Representations and Warranties. Except as affected by the transactions contemplated in the Credit Agreement and this Second Amendment, each of the representations and warranties made by the Company and the

Guarantors in or pursuant to the Financing Documents, including the Credit Agreement, shall be true and correct in all material respects as of the Effective Date, as if made on and as of such date.

Section 3.04 No Default. No Default or Event of Default shall have occurred and be continuing as of the Effective Date.

Section 3.05 Security Instruments. All of the Security Instruments (subject to any partial releases thereof) shall be in full force and effect and provide to the Administrative Agent the security intended thereby to secure the Indebtedness.

Section 3.06 Other Instruments or Documents. The Administrative Agent or any Lender or counsel to the Administrative Agent shall receive such other instruments or documents as they may reasonably request.

ARTICLE IV. MISCELLANEOUS

Section 4.01 Adoption, Ratification and Confirmation of Credit Agreement. Each of the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders does hereby adopt, ratify and confirm the Credit Agreement, as amended hereby, and acknowledges and agrees that the Credit Agreement, as amended hereby, is and remains in full force and effect.

Section 4.02 Ratification and Affirmation of Guaranty. Each of the Guarantors hereby expressly (i) acknowledges the terms of this Second Amendment, (ii) ratifies and affirms its obligations under the Second Amended and Restated Guaranty Agreement dated as of

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January 28, 1997, in favor of the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders, as amended, supplemented or otherwise modified ("Guaranty Agreement"), (iii) acknowledges, renews and extends its continued liability under the Guaranty Agreement and agrees that such Guaranty Agreement remains in full force and effect; and (iv) guarantees to the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender to promptly pay when due all amounts owing or to be owing by it under the Guaranty Agreement pursuant to the terms and conditions thereof.

Section 4.03 Successors and Assigns. This Second Amendment shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns permitted pursuant to the Credit Agreement.

Section 4.04 Counterparts. This Second Amendment may be executed by one or more of the parties hereto in any number of separate counterparts, and all of such counterparts taken together shall be deemed to constitute one and the same

instrument and shall be enforceable as of the Effective Date upon the execution of one or more counterparts hereof by the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders. In this regard, each of the parties hereto acknowledges that a counterpart of this Second Amendment containing a set of counterpart execution pages reflecting the execution of each party hereto shall be sufficient to reflect the execution of this Second Amendment by each necessary party hereto and shall constitute one instrument.

Section 4.05 Number and Gender. Whenever the context requires, reference herein made to the single number shall be understood to include the plural; and likewise, the plural shall be understood to include the singular. Words denoting sex shall be construed to include the masculine, feminine and neuter, when such construction is appropriate; and specific enumeration shall not exclude the general but shall be construed as cumulative. Definitions of terms defined in the singular or plural shall be equally applicable to the plural or singular, as the case may be, unless otherwise indicated.

Section 4.06 Entire Agreement. This Second Amendment constitutes the entire agreement among the parties hereto with respect to the subject hereof. All prior understandings, statements and agreements, whether written or oral, relating to the subject hereof are superseded by this Second Amendment.

Section 4.07 Invalidity. In the event that any one or more of the provisions contained in this Second Amendment shall for any reason be held invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Second Amendment.

Section 4.08 Titles of Articles, Sections and Subsections. All titles or headings to Articles, Sections, subsections or other divisions of this Second Amendment or the exhibits hereto, if any, are only for the convenience of the parties and shall not be construed to have any effect or meaning with

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respect to the other content of such Articles, Sections, subsections, other divisions or exhibits, such other content being controlling as the agreement among the parties hereto.

Section 4.09 Governing Law. This Second Amendment and the rights and obligations of the parties hereunder and under the Credit Agreement shall be governed by and construed in accordance with the laws of the State of Texas and the United States of America.

THIS SECOND AMENDMENT, THE CREDIT AGREEMENT, AS AMENDED AND SUPPLEMENTED HEREBY, THE NOTES, AND THE OTHER FINANCING DOCUMENTS CONSTITUTE A WRITTEN LOAN AGREEMENT AND REPRESENT THE FINAL

AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

[SIGNATURES BEGIN NEXT PAGE]

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IN WITNESS WHEREOF, the parties hereto have caused this Second Amendment to be duly executed and delivered by their proper and duly authorized officers as of the Effective Date.

COMPANY: TESORO PETROLEUM CORPORATION

By: /s/ G. A. Wright
Name: G. A. Wright
Title: Vice President and Treasurer

ADMINISTRATIVE AGENT,
ISSUING BANK AND LENDER: BANQUE PARIBAS, individually, as an Issuing Bank and as Administrative Agent

By: /s/ B. Malone
Name: Brian Malone
Title: Vice President

By: /s/ Larry Robinson
Name: Larry Robinson
Title: Vice President

DOCUMENTATION AGENT,
ISSUING BANK AND LENDER: THE BANK OF NOVA SCOTIA

By: /s/ F.C.H. Ashby
Name: F.C.H. Ashby
Title: Senior Manager
Loan Operations

LENDERS:

BANK OF SCOTLAND

By: /s/ Annie Chin Tat
Name: Annie Chin Tat
Title: Assistant Vice President

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CHRISTIANIA BANK OG KREDITKASSE

By: /s/ Williams S. Phillips
Name: Williams S. Phillips
Title: Vice President

By: /s/ Peter M. Dodge
Name: Peter M. Dodge
Title: First Vice President

THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as an Issuing Bank

By: /s/ D. Andrew Bateman
Name: D. Andrew Bateman
Title: Authorized Agent

FIRST UNION NATIONAL BANK OF NORTH
CAROLINA

By: /s/ Michael J. Kolosowsky
Name: Michael J. Kolosowsky
Title: Vice President

NATIONAL BANK OF CANADA

By: /s/ John T. Dixon
Name: John T. Dixon
Title: Vice President

By: /s/ Doug G. Clark
Name: Doug G. Clark
Title: Vice President

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<PAGE>

THE FROST NATIONAL BANK

By: /s/ Jim Crosby
Name: Jim Crosby
Title: SVP

DEN NORSKE BANK ASA

By: /s/ Byron L. Cooley
Name: Byron L. Cooley
Title: Senior Vice President

By: /s/ Morten Bjornsen
Name: Morten Bjornsen
Title: Senior Vice President

GUARANTORS:

TESORO ALASKA PETROLEUM COMPANY
TESORO EXPLORATION AND PRODUCTION
COMPANY
TESORO PETROLEUM COMPANIES, INC.
DIGICOMP, INC.
TESORO TECHNOLOGY PARTNERS COMPANY
INTERIOR FUELS COMPANY
TESORO ALASKA PIPELINE COMPANY
TESORO NORTHSTORE COMPANY
TESORO REFINING, MARKETING & SUPPLY
COMPANY
TESORO NATURAL GAS COMPANY
TESORO BOLIVIA PETROLEUM COMPANY
TESORO VOSTOK COMPANY
KENAI PIPE LINE COMPANY
TESORO MARINE SERVICES COMPANY
TESORO COASTWIDE SERVICES COMPANY
COASTWIDE MARINE SERVICES, INC.

By: /s/ G. A. Wright
Name: G. A. Wright
Title: Vice President and Treasurer

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TESORO GAS RESOURCES COMPANY, INC.
TESORO FINANCIAL SERVICES HOLDING COMPANY

By: /s/ J. B. Fabian
Name: Jeffrey B. Fabian
Title: President

VICTORY FINANCE COMPANY

By: /s/ David W. Dupert
Name: David W. Dupert
Title: President

TESORO E&P COMPANY, L.P.

By: TESORO EXPLORATION AND PRODUCTION
COMPANY, as its general partner

By: /s/ G. A. Wright
Name: G. A. Wright
Title: Vice President and Treasurer

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THIRD AMENDMENT TO
AMENDED AND RESTATED CREDIT AGREEMENT

Among

TESORO PETROLEUM CORPORATION
as the Company

and

BANQUE PARIBAS
Individually, as an Issuing Bank and as Administrative Agent,

THE BANK OF NOVA SCOTIA
Individually and as Documentation Agent

and

THE FINANCIAL INSTITUTIONS
NOW OR HEREAFTER PARTIES HERETO

Effective as of September 15, 1997

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THIRD AMENDMENT TO
AMENDED AND RESTATED CREDIT AGREEMENT

This THIRD AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (this "Third Amendment") executed effective as of September 15, 1997 (the "Effective Date"), is by and among TESORO PETROLEUM CORPORATION, a Delaware corporation (the "Company"); BANQUE PARIBAS, individually, as an Issuing Bank and as Administrative Agent, THE BANK OF NOVA SCOTIA, individually and as Documentation Agent, and each of the lenders that is a signatory hereto or which becomes a party hereto as provided in Section 9.07 (individually, a "Lender" and, collectively, the "Lenders").

W I T N E S S E T H:

- - - - -

WHEREAS, the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders are parties to that certain Amended and Restated Credit Agreement dated as of June 7, 1996, as amended by First Amendment to Amended and Restated Credit Agreement dated as of March 21, 1997 and Second Amendment to Amended and Restated Credit Agreement dated as of March 31, 1997 (the "Credit Agreement"), pursuant to which the Lenders agreed to make loans and issue Letters of Credit to and for the account of the Company; and

WHEREAS, the Company, the Guarantors, the Administrative Agent, the Documentation Agent, and the Lenders desire to amend the Credit Agreement in the particulars hereinafter provided;

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties hereto agree as follows:

ARTICLE I. DEFINITIONS

Section 1.01 Terms Defined Above. As used in this Third Amendment, each of the terms "Company", "Credit Agreement", "Effective Date", "Third Amendment", and "Lenders" shall have the meaning assigned to such term hereinabove.

Section 1.02 Terms Defined in Credit Agreement. Each term defined in the Credit Agreement and used herein without definition shall have the meaning assigned to such term in the Credit Agreement, unless expressly provided to the contrary.

Section 1.03 Other Definitional Provisions.

(a) The words "hereby", "herein", "hereinafter", "hereof", "hereto" and "hereunder" when used in this Third Amendment shall refer to this Third Amendment as a whole and not to any particular Article, Section, subsection or provision of this Third Amendment.

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(b) Section, subsection and Exhibit references herein are to such Sections, subsections and Exhibits to this Third Amendment unless otherwise specified.

ARTICLE II. AMENDMENTS TO CREDIT AGREEMENT

The Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders agree that the Credit Agreement is hereby amended, effective as of the Effective Date, in the following particulars.

Section 2.01 Amendments and Supplements to Definitions.

(a) The definition of "Agreement" in Section 1.01 of the Credit Agreement is hereby amended to mean the Credit Agreement, as amended by this Third Amendment and as the same may from time to time be further amended, supplemented or modified.

(b) The following terms, which are defined in Section 1.01 of the Credit Agreement, are hereby amended in their entirety to read as follows:

"Applicable Margin" shall mean (i) 0% per annum with respect to Base Rate Loans, and (ii) 1.0% per annum with respect to Eurodollar Loans; provided, however, that during any Deficiency Period, the "Applicable Margin" as would otherwise be in effect shall be increased by 2.0% per annum for both Base Rate Loans and Eurodollar Loans.

"Borrowing Base" shall mean at any time the amount equal to the sum of (i) eighty five percent (85%) of Eligible Accounts plus (ii) seventy percent (70%) of the Loan Value of Eligible Inventory; plus (iii) one hundred percent (100%) of the E&P Borrowing Base.

"Cash Flow" shall mean, as to any Person, the sum of the net income of such Person after taxes for any period plus, to the extent deducted from net income, all non-cash items, including, but not limited to, depreciation, depletion and impairment, amortization of leasehold and intangibles, deferred taxes and write-offs of exploration costs and producing lease abandonments plus, but without duplication, to the extent deducted from net income, cash not to exceed \$15,000,000, and all non-cash items related to that certain special incentive compensation award program which will be funded if the Company's stock price reaches an average price per share of \$20 or higher over 20 consecutive trading days after June 30, 1997, and before December 31, 1998; in each case for such period and determined as to such Person.

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"Consolidated Tangible Net Worth" shall mean, at any time and from time to time, the sum of preferred or common stock not subject to a mandatory redemption obligation (other than a mandatory redemption obligation that can be satisfied by the tendering of common stock of the Company) as of the date of determination, par value of common stock, additional paid-in capital of common stock and retained earnings, plus to the extent deducted from net income, cash not to exceed \$15,000,000 and all non-cash items related to that certain special incentive compensation award program which will be funded if the Company's stock price reaches an average price per share of \$20 or higher over 20 consecutive trading days after June 30, 1997, and before December 31, 1998, less treasury stock (if any), less goodwill, cost in excess of net assets acquired and all other assets as are properly classified as intangible assets, all as determined as to the Company and its Subsidiaries on a consolidated basis.

"EBITDA" shall mean, as to the Company and its Subsidiaries on a consolidated basis and, for each Rolling Period, the amount equal to net income of the Company and its Subsidiaries, less any non-cash income included in net income to the extent the applicable cash was not received at any time during such Rolling Period, plus, to the extent deducted from net income, interest expense, depreciation, depletion and

impairment, amortization of leasehold and intangible, other non-cash expenses (including, but not limited to taxes (excluding Bolivian taxes paid in kind), plus, but without duplication, to the extent deducted from net income, cash not to exceed \$15,000,000 and all non-cash items related to that certain special incentive compensation award program which will be funded if the Company's stock price reaches an average price per share of \$20 or higher over 20 consecutive trading days after June 30, 1997, and before December 31, 1998; provided, that, gains or losses on the disposition of assets shall not be included in EBITDA.

"Eligible Inventory" shall mean, at any time, all inventory (as such term is defined in Section 9-109(4) of the UCC) of the Inventory Borrowing Base Parties, including, without limitation, but without duplication, the In Transit Inventory, inventory in the Tesoro Terminals, inventory at the KPL Facility (as defined in clause (x) below), and Consigned Inventory for which each of the following statements is accurate and complete (and the Company by including such inventory in any computation of the Borrowing Base shall be deemed to represent and warrant to the Administrative Agent, each Issuing Bank and each Lender the accuracy and completeness of such statements):

(a) Said inventory is, and at all times will be, free and clear of all Liens (except for perfected Liens in favor of the Administrative Agent and, in the case of In Transit Inventory described in the definition of In Transit Inventory below, Liens securing the payment of tariffs owed by Tesoro Alaska to a common carrier

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transporting feedstocks or blendstocks through the Trans-Alaska Pipeline System or the KPL Facility, as defined below), and the Administrative Agent has a first priority, perfected security interest in such inventory;

(b) Said inventory does not include capitalized goods which are part of inventory of any Inventory Borrowing Base Party;

(c) Said inventory is located in the states of Alaska, California, Texas, Louisiana, Oregon or Washington, or the Yukon territory or British Columbia, Canada, or to the extent that it qualifies as In Transit Inventory, is located in the territorial waters of the states of Alaska, California, Oregon, Texas, Louisiana, Washington or the Yukon territory or British Columbia, Canada (and not in international waters); and

(d) Said inventory, excluding Consigned Inventory, is not stored at any terminal other than a Tesoro Terminal.

For purposes of this definition, "In Transit Inventory" shall mean, at any time, feedstocks, blendstocks or refined products, including asphalt, solely owned by an Inventory Borrowing Base Party that are in transit:

(x) to the Kenai Refinery (i) from Pump Station No. 1 on the Trans-Alaska Pipeline System, including feedstocks or blendstocks in storage at the Valdez Terminal in Valdez, Alaska, (ii) in a tanker or barge located within Alaska, California, Washington or the Yukon territory or British Columbia, Canada or their respective territorial waters (and not in international waters) that has been time chartered by any Inventory Borrowing Base Party, (iii) in or on any pipeline, terminal, dock or storage tank of the KPL in the area of Cook Inlet, Alaska (the "KPL Facility"), or (iv) in the Cook Inlet pipeline system in the area of Cook Inlet, Alaska, including feedstocks or blendstocks in storage at the Drift River Terminal in Drift River, Alaska;

(y) from the Kenai Refinery (i) in a tanker or barge located within Alaska, California, Oregon, Washington or the Yukon territory or British Columbia, Canada or their respective territorial waters (and not in international waters) that has been time chartered by any Inventory Borrowing Base Party, (ii) in the Anchorage Pipeline owned by Tesoro Alaska Pipeline Company (formerly known as the Nikiski Alaska Pipeline), or (iii) in the KPL Facility (as defined in Clause (x) above); or

(z) between Alaska, California, Washington, Texas, Louisiana Oregon or the Yukon territory or British Columbia, Canada and in their respective territorial waters (and not in international waters) and is inventory in which the Administrative Agent has been granted a first priority perfected Lien which is in effect at such time.

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(c) Sect . 1.01 of the Credit Agreement is hereby further amended and supplemented by adding the following new definitions where alphabetically appropriate, which reads in their entirety as follows:

"Consigned Inventory" shall mean inventory owned by an Inventory Borrowing Base Party being held in storage tanks of a third party pursuant to a consignment arrangement between such Inventory Borrowing Base Party and such third party, but not commingled with any other inventory or goods of such third party or other Persons, and for which such Inventory Borrowing Base Party has complied with the requirements of the Uniform Commercial Code, including Section 9.114 thereof, such that such Inventory Borrowing Base Party will have priority over a secured party who is or becomes a creditor of such third party.

"Third Amendment" shall mean that certain Third Amendment to Amended and Restated Credit Agreement dated as of September 15, 1997, by and among the Company, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders.

Section 2.02 Amendments to Article II. Section 2.20(a) of the Credit Agreement is hereby amended by replacing the last sentence thereof in its entirety with the following sentence:

"During the period from and after the effective date of the Third Amendment until the next Redetermination Date occurring after October, 1997, unless redetermined pursuant to any unscheduled redeterminations, the amount of the E&P Borrowing Base shall be \$56,000,000."

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Section 2.03 Amendments to Article V. Section 5.15(h) of the Credit Agreement is hereby amended in its entirety to read as follows:

"(h) Quarterly Borrowing Base Reports. As soon as available and in any event by the 105th day after the end of the fourth calendar quarter of each year and the 60th day after the end of each of the first three calendar quarters of each year of the Company, a quarterly Borrowing Base Report dated and reflecting amounts as of the last day of such calendar year or quarter, as the case may be, which have been reconciled to the financial statements delivered pursuant to Subsection 5.15(a) or (b), as the case may be, and in the case of the fourth calendar quarter, as soon as available and in any event by the 60th day after the end of the fourth calendar quarter of each year, a preliminary Borrowing Base Report for the prior four calendar quarters not reconciled to such financial statements, upon which the Borrowing Base will be determined for the interim period until receipt of the reconciled Borrowing Base Report for such period; provided, however, the Majority Lenders may, at any time, require up to four additional Borrowing Base Reports per calendar year and the Company may, at any time, submit up to four additional Borrowing Base Reports per calendar year, in addition to the four additional Borrowing Base Reports required by the Majority Lenders."

Section 2.04 Amendments to Article VI.

(a) Section 6.01 of the Credit Agreement is hereby amended in its entirety to read as follows:

"Section 6.01 Consolidated Tangible Net Worth. Permit Consolidated Tangible Net Worth as of the end of the calendar quarter to be less than \$189,950,000 plus 75% of the Company's consolidated net income aggregated for each of the calendar quarters from and after July 1, 1997 in which consolidated net income is positive; provided if at any time the Company

issues equity securities of any kind, such minimum amount of Consolidated Tangible Net Worth shall be permanently increased by an amount equal to 75% of the net cash proceeds from the issuance of such equity securities."

(b) Section 6.02 of the Credit Agreement is hereby amended in its entirety to read as follows:

"Section 6.02 Consolidated Current Ratio. Permit the ratio of (i) consolidated current assets to (ii) consolidated current liabilities (excluding current maturities of the Notes) to be less than 1.3 to 1.0 at any time. As used in this Section 6.02 "consolidated current assets" shall mean assets which would, in accordance with GAAP, be included as current assets on a consolidated balance sheet of the Company and its Subsidiaries and "consolidated current liabilities" shall mean liabilities which would, in accordance with GAAP, be included as current liabilities on a consolidated

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balance sheet of the Company and its Subsidiaries; provided, however, for the sole purpose of calculating such ratio, consolidated current liabilities shall not include accrued amounts related to that certain special incentive compensation award program which will be funded if the Company's stock price reaches an average price per share of \$20 or higher over 20 consecutive trading days after June 30, 1997, and before December 31, 1998, except to the extent that the cash component of such accrual exceeds \$15,000,000, such excess shall be included in consolidated current liabilities."

(c) Section 6.03 of the Credit Agreement is hereby amended by replacing the second sentence thereof in its entirety to read as follows:

"As used in this Section 6.03, "cash flow coverage ratio" shall mean, as to the Company, and for the Rolling Period ending on such Quarterly Date, the ratio of (i) the sum of (A) Cash Flow of the Company and its Subsidiaries on a consolidated basis, plus (B) the difference between (x) the lesser of the Aggregate Revolving Credit Commitments or the Borrowing Base on the last day of the applicable Rolling Period and (y) the outstanding principal amount of the Revolving Credit Loans on the first day of the last calendar quarter of such Rolling Period, plus (C) interest expense of the Company and its Subsidiaries on a consolidated basis to (ii) the sum of (A) regularly scheduled principal payments of Funded Indebtedness paid in cash, plus (B) cash interest expense of the Company and its Subsidiaries on a consolidated basis, plus (C) capital expenditures by the Company and its Subsidiaries on a consolidated basis, excluding capital expenditures made by way of (x) exchanges of equity and (y) loans provided by third parties to the extent not prohibited by Section 6.05, plus (D) cash dividends actually paid by the Company and its Subsidiaries on a consolidated basis."

(d) Section 6.05 of the Credit Agreement is hereby amended by adding thereto a new Subsection (o) as follows:

"(o) Unsecured letters of credit (other than Letters of Credit) not to exceed \$25,000,000 in the aggregate; provided, however, if an unsecured letter of credit is issued for the benefit of the State of Alaska, all unsecured letters of credit (other than Letters of Credit) shall not exceed \$40,000,000 in the aggregate."

(e) Clause (v) of Section 6.08 is hereby amended in its entirety to read as follows:

"(v) in an aggregate amount not to exceed \$10,000,000, repurchase the common stock issued by the Company from (A) shareholders owning 100 shares or less pursuant to an oddlot buy back program and (B) the open market or private sales for employee benefit or compensation plans, and"

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ARTICLE III. CONDITIONS

The enforceability of this Third Amendment against the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders is subject to the satisfaction of the following conditions precedent:

Section 3.01 Loan Documents. The Administrative Agent shall have received multiple original counterparts, as requested by the Administrative Agent, of this Third Amendment executed and delivered by a duly authorized officer of the Company, each of the Guarantors, the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender.

Section 3.02 Corporate Proceedings of Loan Parties. The Administrative Agent shall have received multiple copies, as requested by the Administrative Agent, of the resolutions, in form and substance reasonably satisfactory to the Administrative Agent, of the Boards of Directors of the Company and the Guarantors, authorizing the execution, delivery and performance of this Third Amendment, each such copy being attached to an original certificate of the Secretary or an Assistant Secretary of the Company or the Guarantors, as applicable, dated as of the Effective Date, certifying (i) that the resolutions attached thereto are true, correct and complete copies of resolutions duly adopted by written consents or at meetings of the Boards of Directors, (ii) that such resolutions constitute all resolutions adopted with respect to the transactions contemplated hereby, (iii) that such resolutions have not been amended, modified, revoked or rescinded as of the Effective Date, (iv) that the respective articles of incorporation and bylaws of the Company and the Guarantors have not been amended or otherwise modified since the effective date of the Credit Agreement, except pursuant to any amendments attached thereto, and

(v) as to the incumbency and signature of the officers of the Company or the Guarantors, as applicable, executing this Third Amendment.

Section 3.03 Representations and Warranties. Except as affected by the transactions contemplated in the Credit Agreement and this Third Amendment, each of the representations and warranties made by the Company and the Guarantors in or pursuant to the Financing Documents, including the Credit Agreement, shall be true and correct in all material respects as of the Effective Date, as if made on and as of such date.

Section 3.04 No Default. No Default or Event of Default shall have occurred and be continuing as of the Effective Date.

Section 3.05 Security Instruments. All of the Security Instruments (subject to any partial releases thereof) shall be in full force and effect and provide to the Administrative Agent the security intended thereby to secure the Indebtedness.

Section 3.06 Other Instruments or Documents. The Administrative Agent or any Lender or counsel to the Administrative Agent shall receive such other instruments or documents as they may reasonably request.

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ARTICLE IV. MISCELLANEOUS

Section 4.01 Adoption, Ratification and Confirmation of Credit Agreement. Each of the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders does hereby adopt, ratify and confirm the Credit Agreement, as amended hereby, and acknowledges and agrees that the Credit Agreement, as amended hereby, is and remains in full force and effect.

Section 4.02 Ratification and Affirmation of Guaranty. Each of the Guarantors hereby expressly (i) acknowledges the terms of this Third Amendment, (ii) ratifies and affirms its obligations under the Second Amended and Restated Guaranty Agreement dated as of January 28, 1997, in favor of the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders, as amended, supplemented or otherwise modified ("Guaranty Agreement"), (iii) acknowledges, renews and extends its continued liability under the Guaranty Agreement and agrees that such Guaranty Agreement remains in full force and effect; and (iv) guarantees to the Administrative Agent, the Documentation Agent, each Issuing Bank and each Lender to promptly pay when due all amounts owing or to be owing by it under the Guaranty Agreement pursuant to the terms and conditions thereof.

Section 4.03 Successors and Assigns. This Third Amendment shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns permitted pursuant to the Credit Agreement.

Section 4.04 Counterparts. This Third Amendment may be executed by one or more of the parties hereto in any number of separate counterparts, and all of such counterparts taken together shall be deemed to constitute one and the same instrument and shall be enforceable as of the Effective Date upon the execution of one or more counterparts hereof by the Company, the Guarantors, the Administrative Agent, the Documentation Agent, the Issuing Bank and the Lenders. In this regard, each of the parties hereto acknowledges that a counterpart of this Third Amendment containing a set of counterpart execution pages reflecting the execution of each party hereto shall be sufficient to reflect the execution of this Third Amendment by each necessary party hereto and shall constitute one instrument.

Section 4.05 Number and Gender. Whenever the context requires, reference herein made to the single number shall be understood to include the plural; and likewise, the plural shall be understood to include the singular. Words denoting sex shall be construed to include the masculine, feminine and neuter, when such construction is appropriate; and specific enumeration shall not exclude the general but shall be construed as cumulative. Definitions of terms defined in the singular or plural shall be equally applicable to the plural or singular, as the case may be, unless otherwise indicated.

Section 4.06 Entire Agreement. This Third Amendment constitutes the entire agreement among the parties hereto with respect to the subject hereof. All prior understandings, statements and

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agreements, whether written or oral, relating to the subject hereof are superseded by this Third Amendment.

Section 4.07 Invalidity. In the event that any one or more of the provisions contained in this Third Amendment shall for any reason be held invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Third Amendment.

Section 4.08 Titles of Articles, Sections and Subsections. All titles or headings to Articles, Sections, subsections or other divisions of this Third Amendment or the exhibits hereto, if any, are only for the convenience of the parties and shall not be construed to have any effect or meaning with respect to the other content of such Articles, Sections, subsections, other divisions or exhibits, such other content being controlling as the agreement among the parties hereto.

Section 4.09 Governing Law. This Third Amendment and the rights and obligations of the parties hereunder and under the Credit Agreement shall be governed by and construed in accordance with the laws of the State of Texas and the United States of America.

THIS THIRD AMENDMENT, THE CREDIT AGREEMENT, AS AMENDED AND SUPPLEMENTED HEREBY, THE NOTES, AND THE OTHER FINANCING DOCUMENTS CONSTITUTE A WRITTEN LOAN AGREEMENT AND REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

[SIGNATURES BEGIN NEXT PAGE]

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IN WITNESS WHEREOF, the parties hereto have caused this Third Amendment to be duly executed and delivered by their proper and duly authorized officers as of the Effective Date.

COMPANY: TESORO PETROLEUM CORPORATION

By: /s/ G. A. Wright
Name: G.A. Wright
Title: Vice President and Treasurer

GUARANTORS: TESORO ALASKA PETROLEUM COMPANY
TESORO EXPLORATION AND PRODUCTION
COMPANY
TESORO PETROLEUM COMPANIES, INC.
DIGICOMP, INC.
TESORO TECHNOLOGY PARTNERS COMPANY
INTERIOR FUELS COMPANY
TESORO ALASKA PIPELINE COMPANY
TESORO NORTHSTORE COMPANY
TESORO REFINING, MARKETING & SUPPLY
COMPANY
TESORO NATURAL GAS COMPANY
TESORO BOLIVIA PETROLEUM COMPANY
TESORO VOSTOK COMPANY
KENAI PIPE LINE COMPANY
TESORO MARINE SERVICES COMPANY
TESORO COASTWIDE SERVICES COMPANY
COASTWIDE MARINE SERVICES, INC.

By: /s/ G. A. Wright

Name: G.A. Wright
Title: Vice President and Treasurer

TESORO GAS RESOURCES COMPANY, INC.
TESORO FINANCIAL SERVICES HOLDING
COMPANY

By: /s/ Jeffrey B. Fabian
Name: Jeffrey B. Fabian
Title: President

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<PAGE>

VICTORY FINANCE COMPANY

By: /s/ David W. Dupert
Name: David W. Dupert
Title: President

TESORO E&P COMPANY, L.P.

By: TESORO EXPLORATION AND
PRODUCTION COMPANY, as its general
partner

By: /s/ G.A. Wright
Name: G.A. Wright
Title: Vice President and Treasurer

ADMINISTRATIVE AGENT,
ISSUING BANK AND LENDER:

BANQUE PARIBAS, individually, as an Issuing
Bank and as Administrative Agent

By: /s/ Brian Malone
Name: Brian Malone
Title: Vice President

By: /s/ Barton D. Schouest
Name: Barton D. Schouest
Title: Managing Director

DOCUMENTATION AGENT,
ISSUING BANK AND LENDER:

THE BANK OF NOVA SCOTIA

By: /s/ F.C.H. Ashby
Name: F.C.H. Ashby
Title: Senior Manager
Loan Operations

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<PAGE>
LENDERS:

BANK OF SCOTLAND

By: /s/ Annie Chin Tat
Name: Annie Chin Tat
Title: Vice President

CHRISTIANIA BANK OG KREDITKASSE

By: /s/ William S. Phillips
Name: William S. Phillips
Title: Vice President

By: /s/ Peter M. Dodge
Name: Peter M. Dodge
Title: First Vice President

THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as an Issuing Bank

By: /s/ Dixon P. Schultz
Name: Dixon P. Schultz
Title: Vice President

FIRST UNION NATIONAL BANK OF NORTH
CAROLINA

By: /s/ Michael J. Kolosowsky
Name: Michael J. Kolosowsky
Title: Vice President

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<PAGE>

NATIONAL BANK OF CANADA

By: /s/ William Handley
Name: William Handley
Title: Vice President

By: /s/ Doug Clark
Name: Doug Clark
Title: Vice President

THE FROST NATIONAL BANK

By: /s/ Jim Crosby
Name: Jim Crosby
Title: Senior Vice President

DEN NORSKE BANK ASA

By: /s/ Bryon L. Cooley
Name: Bryon L. Cooley
Title: Senior Vice President

By: /s/ William V. Moyer
Name: William V. Moyer
Title: First Vice President

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM TESORO PETROLEUM CORPORATION'S FINANCIAL STATEMENTS AS OF AND FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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FILED AS OF DATE: 19971114

SROS: NYSE

SROS: PSE

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME:

TESORO PETROLEUM CORP /NEW/

CENTRAL INDEX KEY:

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STANDARD INDUSTRIAL CLASSIFICATION:

PETROLEUM REFINING [2911]

IRS NUMBER:

950862768

STATE OF INCORPORATION:

DE

FISCAL YEAR END:

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FILING VALUES:

FORM TYPE: 10-Q

SEC ACT:

SEC FILE NUMBER: 001-03473

FILM NUMBER: 97720404

BUSINESS ADDRESS:

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-3473

TESORO PETROLEUM CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	95-0862768
(State or Other Jurisdiction of	(I.R.S. Employer
Incorporation or Organization)	Identification No.)

8700 TESORO DRIVE, SAN ANTONIO, TEXAS 78217-6218
(Address of Principal Executive Offices) (Zip Code)

210-828-8484
(Registrant's Telephone Number, Including Area Code)

=====

Indicate by check mark whether the Registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the

Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

=====

There were 26,750,314 shares of the Registrant's Common Stock outstanding at October 31, 1997.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997
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PART I - FINANCIAL INFORMATION

ITEM 1.

FINANCIAL STATEMENTS

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands except per share amounts)

	September 30, 1997 ----	December 31, 1996<FN1> ----
ASSETS		
<S>	<C>	<C>
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,379	22,796
Receivables, less allowance for doubtful accounts of \$1,420 (\$1,515 at December 31, 1996).	83,899	128,013
Inventories:		
Crude oil and wholesale refined products, at LIFO.	55,431	55,858
Merchandise and other refined products	14,333	13,539
Materials and supplies	5,138	5,091
Prepayments and other	9,452	12,046
	-----	-----
Total Current Assets.	175,632	237,343
	-----	-----
PROPERTY, PLANT AND EQUIPMENT		
Refining and marketing.	358,792	328,522
Exploration and production (full-cost method of accounting) . .	257,003	198,480
Marine services	38,953	33,820
Corporate	13,170	12,531
	-----	-----
	667,918	573,353

Less accumulated depreciation, depletion and amortization. . .	291,113	256,842
Net Property, Plant and Equipment	376,805	316,511
OTHER ASSETS	35,377	28,733
TOTAL ASSETS	\$ 587,814	582,587
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable.	\$ 57,473	80,747
Accrued liabilities	30,567	33,256
Current income taxes payable.	1,951	13,822
Current maturities of long-term debt and other obligations. . .	9,778	10,043
Total Current Liabilities.	99,769	137,868
DEFERRED INCOME TAXES.	24,552	19,151
OTHER LIABILITIES.	45,786	42,243
LONG-TERM DEBT AND OTHER OBLIGATIONS, LESS		
CURRENT MATURITIES.	90,104	79,260
COMMITMENTS AND CONTINGENCIES (Note 4)		
STOCKHOLDERS' EQUITY		
Common Stock, par value \$.16-2/3; authorized 50,000,000 shares; 26,498,745 shares issued (26,414,134 in 1996).	4,416	4,402
Additional paid-in capital.	190,093	189,368
Retained earnings	134,043	110,295
Treasury stock, 66,998 shares at cost	(949)	-
Total Stockholders' Equity	327,603	304,065
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.	\$ 587,814	582,587
	=====	=====

<FN>

The accompanying notes are an integral part of these condensed consolidated financial statements.
 <FN1> The balance sheet at December 31, 1996 has been taken from the audited consolidated financial statements at the condensed.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
 CONDENSED STATEMENTS OF CONSOLIDATED OPERATIONS
 (Unaudited)
 (In thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
	----	----	----	----
<S>	<C>	<C>	<C>	<C>
REVENUES				
Refining and marketing.	\$ 198,815	203,661	534,986	563,767
Exploration and production.	19,821	26,476	61,769	83,933
Marine services	32,433	32,660	98,266	87,467
Other income.	403	(725)	4,609	4,378
	-----	-----	-----	-----
Total Revenues	251,472	262,072	699,630	739,545
	-----	-----	-----	-----
OPERATING COSTS AND EXPENSES				
Refining and marketing.	188,014	194,156	508,926	545,303
Exploration and production.	3,054	2,416	8,836	8,767
Marine services	29,691	30,273	93,406	82,153
Depreciation, depletion and amortization.	11,357	10,026	34,183	29,797
	-----	-----	-----	-----
Total Operating Costs and Expenses	232,116	236,871	645,351	666,020
	-----	-----	-----	-----
OPERATING PROFIT	19,356	25,201	54,279	73,525
General and Administrative	(3,416)	(3,056)	(9,599)	(8,960)
Interest Expense, Net of Capitalized Interest in 1997	(1,481)	(4,142)	(4,634)	(12,142)
Interest Income.	135	7,100	1,459	7,681
Other Expense, Net	(1,233)	(1,254)	(3,465)	(8,802)
	-----	-----	-----	-----
EARNINGS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM.	13,361	23,849	38,040	51,302

Income Tax Provision		5,382	7,686	14,292	17,159
		-----	-----	-----	-----
EARNINGS BEFORE EXTRAORDINARY ITEM		7,979	16,163	23,748	34,143
Extraordinary Loss on Extinguishment of Debt, Net of Income Tax Benefit of \$886 in 1996.		-	(2,290)	-	(2,290)
		-----	-----	-----	-----
NET EARNINGS	\$	7,979	13,873	23,748	31,853
		=====	=====	=====	=====
EARNINGS PER SHARE					
Earnings Before Extraordinary Item.	\$	.30	.61	.88	1.30
Extraordinary Loss, Net of Income Tax Benefit . . .		-	(.09)	-	(.09)
		-----	-----	-----	-----
Net Earnings.	\$	.30	.52	.88	1.21
		=====	=====	=====	=====
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES					
		26,938	26,816	26,857	26,370
		=====	=====	=====	=====

<FN>

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended September 30	
	1997	1996
	-----	-----
	<C>	<C>
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES		
Net earnings	\$ 23,748	31,853
Adjustments to reconcile net earnings to net cash from operating activities:		
Extraordinary loss on extinguishment of debt, net of income tax benefit . .	-	2,290
Depreciation, depletion and amortization.	34,643	30,386
Loss on sale of assets.	30	678
Amortization of deferred charges and other.	622	1,316
Changes in operating assets and liabilities:		
Receivable from Tennessee Gas Pipeline Company.	-	50,680

Receivables, other trade.	45,882	(6,228)
Inventories	358	16,901
Other assets.	(3,219)	793
Accounts payable and other current liabilities.	(38,557)	8,066
Obligation payments to State of Alaska.	(3,406)	(3,145)
Deferred income taxes	5,401	12,051
Other liabilities and obligations	5,569	2,760
	-----	-----
Net cash from operating activities	71,071	148,401
	-----	-----
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(95,082)	(46,050)
Acquisition of Coastwide Energy Services, Inc.	-	(7,720)
Other.	(3,155)	(3,259)
	-----	-----
Net cash used in investing activities.	(98,237)	(57,029)
	-----	-----
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Borrowings, net of repayments of \$28,500 in 1997 and \$112,000 in 1996, under revolving credit facilities.	15,828	-
Payments of long-term debt	(3,287)	(2,885)
Purchase of treasury stock	(1,098)	-
Other.	306	1,144
	-----	-----
Net cash from (used in) financing activities	11,749	(1,741)
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(15,417)	89,631
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	22,796	13,941
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD \$	7,379	103,572
	=====	=====
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Interest paid, net of \$313 capitalized in 1997 \$	1,654	8,879
	=====	=====
Income taxes paid. \$	20,764	3,925
	=====	=====

<FN>

The accompanying notes are an integral part of these condensed consolidated financial statements.

</TABLE>

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TESORO PETROLEUM CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

The interim condensed consolidated financial statements and notes thereto of Tesoro Petroleum Corporation and its subsidiaries (collectively, the "Company" or "Tesoro") have been prepared by management without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, the accompanying financial statements reflect all adjustments that, in the opinion of management, are necessary for a fair presentation of results for the periods presented. Such adjustments are of a normal recurring nature. Certain information and notes normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC's rules and regulations. However, management believes that the disclosures presented herein are adequate to make the information not misleading. The accompanying condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 1996.

The preparation of these condensed consolidated financial statements required the use of management's best estimates and judgment that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of results for the full year.

Certain reclassifications have been made to amounts previously reported to conform to the current presentation of financial information.

NOTE 2 - ACQUISITION

In July 1997, the Company purchased the interests held by Zapata Exploration Company ("Zapata"), a wholly-owned subsidiary of Zapata Corporation, in two jointly held contract blocks (Block 18 and Block 20) in southern Bolivia. Zapata held a 25% interest in Block 18 and a 27.4% interest in Block 20. The purchase price was approximately \$20 million, which included working capital and assumption of certain liabilities. The assignment of interests has been approved by the Bolivian government. The Company's net proved Bolivian reserves, which were estimated to be 253 billion cubic feet equivalent at 1996 year-end, increased more than 30% as a result of the acquisition.

NOTE 3 - LONG-TERM DEBT

In September 1997, the Company negotiated an amendment to its \$150 million corporate revolving credit facility ("Credit Facility"). The amendment reduces the rate on cash borrowings under the Credit Facility to (i) the London Interbank Offered Rate ("LIBOR") plus 1.0% or (ii) the prime rate. Fees on outstanding letters of credit are reduced to 1.0%. The amendment also increases the Company's borrowing base and makes certain covenants in the Credit Facility less restrictive. Additionally, the Company is now permitted to utilize unsecured letters of credit outside of the Credit Facility up to \$40 million (none outstanding at September 30, 1997). Under the Credit Facility, the Company had letters of credit of \$33.9 million, primarily for royalty crude oil purchases from the State of Alaska, and cash borrowings of \$11.9 million outstanding at September 30, 1997.

In early October 1997, the Company completed an expansion of the hydrocracker unit at its Alaska refinery. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of approximately \$19 million and is expected to improve the Company's refinery feedstock and product slate beginning in the fourth quarter of 1997. In October 1997, the National Bank of Alaska ("NBA") and the Alaska Industrial Development and Export Authority ("AIDEA"), under a loan agreement ("Hydrocracker Loan") entered into between the Company and NBA, provided a \$16.2 million loan to the Company towards the cost of the hydrocracker expansion. One-half of the loan was funded by NBA and the other half was funded by AIDEA. The Hydrocracker Loan matures on or before April 1, 2005 and requires 28 equal quarterly principal payments beginning April 1998 together with interest at the unsecured 90-day commercial paper rate (5.55% at October 30, 1997) plus (i) 2.6% per annum on 50% of the amount borrowed and (ii) 2.35% per annum on the other 50% borrowed, each to be

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adjusted quarterly. The Hydrocracker Loan is secured by a second lien on the refinery. Under the terms of the Hydrocracker Loan, the Company is required to maintain specified levels of working capital and tangible net worth.

NOTE 4 - COMMITMENTS AND CONTINGENCIES

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, which change frequently, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites or install additional controls or other modifications or changes in use for certain emission sources. The Company is currently involved with a waste disposal site near Abbeville, Louisiana, at which it has been named a potentially responsible party under the Federal Superfund law. Although this law might impose joint and several liability upon each party at the site, the extent of the Company's allocated financial contributions to the cleanup of the site is expected to be limited based upon

the number of companies, volumes of waste involved and an estimated total cost of approximately \$500,000 among all of the parties to close the site. The Company is currently involved in settlement discussions with the Environmental Protection Agency and other potentially responsible parties at the Abbeville, Louisiana site. The Company expects, based on these discussions, that its liability will not exceed \$25,000. The Company is also involved in remedial responses and has incurred cleanup expenditures associated with environmental matters at a number of sites, including certain of its own properties.

At September 30, 1997, the Company's accruals for environmental expenses amounted to \$8.7 million, which included a noncurrent liability of approximately \$3.1 million for remediation of Kenai Pipe Line Company's ("KPL") properties that has been funded by the former owners of KPL through a restricted escrow deposit. Based on currently available information, including the participation of other parties or former owners in remediation actions, the Company believes these accruals are adequate. In addition, to comply with environmental laws and regulations, the Company currently anticipates that it will make capital improvements of approximately \$3 million in 1997 and \$8 million in 1998. The Company also expects to spend approximately \$6 million by the year 2002 for secondary containment systems for existing storage tanks in Alaska.

Conditions that require additional expenditures may exist for various Company sites, including, but not limited to, the Company's refinery, retail gasoline outlets (current and closed locations) and petroleum product terminals, and for compliance with the Clean Air Act. The amount of such future expenditures cannot currently be determined by the Company.

NOTE 5 - STOCKHOLDERS' EQUITY

STOCK REPURCHASE PROGRAM

On May 7, 1997, the Company's Board of Directors authorized the repurchase of up to 3 million shares (approximately 11% of the current outstanding shares) of Tesoro Common Stock in a buyback program that will extend through the end of 1998. Under the program, subject to certain conditions, the Company may repurchase from time to time Tesoro Common Stock in the open market and through privately negotiated transactions. Purchases will depend on price, market conditions and other factors and will be made primarily from cash flows. The repurchased Common Stock is accounted for as treasury stock and may be used for employee benefit plan requirements and other corporate purposes. For further information on the repurchase program and related restrictions, see "Capital Resources and Liquidity" in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 herein.

INCENTIVE COMPENSATION STRATEGY

In June 1996, the Company's Board of Directors unanimously approved a special incentive compensation strategy in order to encourage a longer-term focus for

all employees to perform at an outstanding level. The strategy provides eligible employees with incentives to achieve a significant increase in the market price of the Company's Common Stock. Under the strategy, awards would be earned only if the market price of the Company's Common

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Stock reaches an average price per share of \$20 or higher over any 20 consecutive trading days after June 30, 1997 and before December 31, 1998 (the "Performance Target"). In connection with this strategy, non-executive employees will be able to earn cash bonuses equal to 25% of their individual payroll amounts for the previous twelve complete months and certain executives have been granted, from the Company's Amended and Restated Executive Long-Term Incentive Plan ("Plan"), a total of 340,000 stock options at an exercise price of \$11.375 per share, the fair market value (as defined in the Plan) of a share of the Company's Common Stock on the date of grant, and 350,000 shares of restricted Common Stock, all of which vest only upon achieving the Performance Target.

NOTE 6 - ACCOUNTING PRONOUNCEMENTS

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 becomes effective for the Company in the fourth quarter of 1997. At that time, the Company will be required to present "basic" and "diluted" earnings per share and to restate earnings per share data presented in prior periods. Early adoption is not permitted. The Company believes that the adoption of SFAS No. 128 will not materially impact its earnings per share disclosures.

In June 1997, the FASB issued SFAS No.130, "Reporting Comprehensive Income," and SFAS No.131, "Disclosures about Segments of an Enterprise and Related Information." Both Statements become effective for periods beginning after December 15, 1997 with early adoption permitted. The Company is evaluating the effects these Statements will have on its financial reporting and disclosures. The Statements will have no effect on the Company's results of operations, financial position, capital resources or liquidity.

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ITEM 2.

TESORO PETROLEUM CORPORATION AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS - THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1997
COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1996

SUMMARY

Net earnings of \$8.0 million, or \$.30 per share, for the three months ended September 30, 1997 ("1997 Quarter") compare with net earnings of \$13.9 million, or \$.52 per share, for the three months ended September 30, 1996 ("1996 Quarter"). For the year-to-date period, net earnings of \$23.8 million, or \$.88 per share, for the nine months ended September 30, 1997 ("1997 Period") compare with net earnings of \$31.9 million, or \$1.21 per share, for the nine months ended September 30, 1996 ("1996 Period"). Results for the 1996 Quarter and Period included revenues from sales of natural gas at above-market prices under a contract with Tennessee Gas Pipeline Company ("Tennessee Gas") which was terminated effective October 1, 1996. Results of operations in 1997 and future years will no longer include above-market revenues from this contract. Significant items, including the impact of the Tennessee Gas contract, which affect the comparability between results for 1997 and 1996 are highlighted in the table below (in millions except per share amounts):

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
	----	----	----	----
<S>	<C>	<C>	<C>	<C>
Net Earnings As Reported	\$ 8.0	13.9	23.8	31.9
Extraordinary Loss on Debt Extinguishment, Net of Income Tax Benefit.	-	2.3	-	2.3
	-----	-----	-----	-----
Earnings Before Extraordinary Item	8.0	16.2	23.8	34.2
	-----	-----	-----	-----
Significant Items Affecting Comparability, Pretax:				
Operating profit from excess of Tennessee Gas contract prices over spot market prices	-	8.5	-	24.6
Interest and reimbursement of fees and costs from resolution of litigation.	-	7.9	-	7.9
Income from collection of Bolivian receivable.	-	-	2.2	-
Income from retroactive severance tax refunds.	-	-	1.8	5.0
Costs of shareholder consent solicitation resolved in April 1996	-	-	-	(2.3)
Employee terminations, restructuring costs and other	-	(.7)	-	(4.5)
	-----	-----	-----	-----
Total Significant Items, Pretax	-	15.7	4.0	30.7
Income Tax Effect	-	4.4	1.2	8.3
	-----	-----	-----	-----

Total Significant Items, Aftertax	-	11.3	2.8	22.4
	-----	-----	-----	-----
Net Earnings Excluding Significant Items and Extraordinary Loss	\$ 8.0	4.9	21.0	11.8
	=====	=====	=====	=====
Earnings Per Share:				
As Reported.	\$.30	.52	.88	1.21
Extraordinary Loss	-	(.09)	-	(.09)
Significant Items:				
Impact of Tennessee Gas contract prices over spot market prices	-	.23	-	.68
Other significant items.	-	.20	.10	.17
	-----	-----	-----	-----
Excluding Significant Items and Extraordinary Loss	\$.30	.18	.78	.45
	=====	=====	=====	=====

</TABLE>

As shown above, net earnings of \$8.0 million (\$.30 per share) in the 1997 Quarter would compare to \$4.9 million (\$.18 per share) when excluding the significant items in the 1996 Quarter. The resulting increase in net earnings in the 1997 Quarter was mainly attributable to improved profitability from each of the Company's business segments together with lower corporate interest expense. For the year-to-date periods, excluding significant items, net earnings would have been \$21.0 million (\$.78 per share) for the 1997 Period compared to \$11.8 million (\$.45 per share) for the 1996 Period. The increase in the 1997 Period was primarily due to higher spot market natural gas prices, better refined product margins and lower corporate interest expense. A discussion and analysis of the factors contributing to the Company's results of operations are presented below. The Company conducts its operations in the following business segments: Refining and Marketing, Exploration and Production, and Marine Services.

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<TABLE>

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REFINING AND MARKETING

(Dollars in millions except per unit amounts)

Three Months Ended September 30,		Nine Months Ended September 30,	
1997	1996	1997	1996
----	----	----	----

	<C>	<C>	<C>	<C>
Gross Operating Revenues:				
Refined products.	\$ 177.5	169.9	486.9	465.7
Other, primarily crude oil resales and merchandise. . . .	21.3	33.8	48.1	98.1

Gross Operating Revenues	\$	198.8	203.7	535.0	563.8
		=====	=====	=====	=====
Total Operating Profit:					
Gross margin.	\$	34.2	31.7	94.8 <i>18%</i>	85.5 <i>15%</i>
Operating expenses.		23.3	22.3	68.7	67.1
Depreciation and amortization		3.4	3.0	9.7	9.0
Loss on sale of assets and other.		.1	.7	.1	.7
		-----	-----	-----	-----
Operating Profit	\$	7.4	5.7	16.3	8.7
		=====	=====	=====	=====
Capital Expenditures	\$	11.8	3.1	30.6	6.9
		=====	=====	=====	=====
Refinery Throughput:					
Barrels per day		43,192	41,165	48,225	45,760
% Alaska North Slope crude oil.		68%	69%	77%	71%
Refined Products Manufactured (average daily barrels)<FN1>:					
Gasoline		11,351	10,953	12,499	12,717
Middle distillates.		17,999	17,690	20,400	19,143
Heavy oils and residual product		12,587	11,638	14,140	12,829
Other		1,910	2,214	2,500	2,709
		-----	-----	-----	-----
Total Refined Products Manufactured.		43,847	42,495	49,539	47,398
		=====	=====	=====	=====
Refinery Operations - Product Spread (\$/barrel)<FN1>:					
Average yield value of products manufactured.	\$	23.81	25.07	23.83	23.87
Cost of raw materials		17.92	19.33	18.69	19.03
		-----	-----	-----	-----
Refinery Product Spread.	\$	5.89	5.74	5.14	4.84
		=====	=====	=====	=====
Non-Refinery Margin, included in operating profit above (\$ millions)<FN1><FN2>	\$	10.8	10.0	27.1	24.9
		=====	=====	=====	=====
Total Segment Product Sales (average daily barrels)<FN3>:					
Gasoline.		18,592	18,073	18,156	18,751
Middle distillates.		37,844	32,123	30,138	30,159
Heavy oils and residual product		13,748	16,489	17,700	14,594
		-----	-----	-----	-----
Total Product Sales.		70,184	66,685	65,994	63,504

	=====	=====	=====	=====
Total Segment Product Sales Prices (\$/barrel):				
Gasoline.	\$ 35.23	34.52	33.90	32.35
Middle distillates.	\$ 27.00	29.33	28.46	28.08
Heavy oils and residual product	\$ 18.40	17.03	17.53	16.86
Total Segment Gross Margins on Product				
Sales (\$/barrel)<FN4>:				
Average sales price	\$ 27.49	27.70	27.03	26.76
Average costs of sales.	22.80	23.16	22.52	22.43
	-----	-----	-----	-----
Gross Margin	\$ 4.69	4.54	4.51	4.33
	=====	=====	=====	=====

<FN>

<FN1> Amounts reported in prior periods have been reclassified to conform with current presentation.

<FN2> Non-refinery margin includes margins on products purchased and resold, margins on products sold in markets outside of Alaska, intrasegment pipeline revenues, retail margins, and adjustments due to selling a volume and mix of products that is different than actual volumes manufactured.

<FN3> Sources of total products sales include products manufactured at the refinery, products drawn from inventory balances and products purchased from third parties. The Company's purchases of refined products for resale averaged approximately 24,700 and 13,600 barrels per day for the three months ended September 30, 1997 and 1996, respectively, and approximately 15,500 and 12,100 barrels per day for the nine months ended September 30, 1997 and 1996, respectively.

<FN4> Gross margins on total product sales include margins on sales of purchased products, together with the effect of changes in inventories.

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REFINING AND MARKETING

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.4 million from the Company's Refining and Marketing segment during the 1997 Quarter represented a 30% improvement from the 1996 Quarter. The continued success of the Company's program to sell a larger portion of its refinery production within the core Alaska market, together with generally favorable industry conditions, contributed to this improvement. The Company's sales of gasoline and asphalt in Alaska increased in the 1997 Quarter as compared to the 1996 Quarter. Jet fuel sales also increased due to growing trans-Pacific air cargo traffic through the international airport in Anchorage.

The Company's refinery product spread averaged \$5.89 per barrel in the 1997 Quarter, a \$.15 per barrel improvement from the 1996 Quarter. The Company's refined product yield values decreased by 5% to \$23.81 per barrel in the 1997 Quarter from \$25.07 per barrel in the 1996 Quarter, while the Company's feedstock costs decreased by 7% to \$17.92 per barrel in the 1997 Quarter from

\$19.33 per barrel in the 1996 Quarter. The 1997 Quarter and 1996 Quarter both included scheduled turnarounds, during which the refinery was not fully operational. Margins from non-refinery activities increased to \$10.8 million during the 1997 Quarter from \$10.0 million in the 1996 Quarter due primarily to higher retail sales and improved margins on refined products sold outside Alaska.

The increase of \$7.6 million in revenues from refined products sales during the 1997 Quarter was primarily due to higher sales volumes, which rose 5% to 70,184 barrels per day in the 1997 Quarter from 66,685 barrels per day in the 1996 Quarter. Other revenues declined by \$12.5 million due primarily to lower sales volumes of previously purchased crude oil together with lower prices. During the 1997 Quarter, the Company had less crude oil available for resale as refinery throughput averaged 2,027 barrels per day more than in the 1996 Quarter. Costs of sales decreased in the 1997 Quarter due to lower prices for crude oil and refined products. The \$1.0 million increase in operating expenses included higher employee costs associated in part with expanded marketing efforts and higher professional fees. The 1996 Quarter included a \$.7 million write-down of a West Coast terminal that was subsequently sold.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$16.3 million in the 1997 Period compares to operating profit of \$8.7 million in the 1996 Period. The Company's refinery spread of \$5.14 per barrel in the 1997 Period improved 6% from the prior year period. The Company's production of jet fuel, a product in short supply in Alaska, was higher in the 1997 Period principally due to the use of an improved catalyst in the hydrocracker unit, a change made during the refinery turnaround in the 1996 Period. Margins from non-refinery activities increased to \$27.1 million during the 1997 Period as compared to \$24.9 million in the 1996 Period due primarily to higher retail sales and improved margins on refined products sold outside of Alaska.

Revenues from sales of refined products in the Company's Refining and Marketing segment increased by 5% during the 1997 Period due to higher sales volumes and prices. Other revenues declined by \$50.0 million during the 1997 Period due primarily to lower sales volumes of crude oil together with lower prices. During the 1997 Period, the Company had less crude oil available for resale as refinery throughput averaged 2,465 barrels per day more than in the 1996 Period and fewer spot purchases of crude oil were made. Costs of sales decreased in the 1997 Period due to lower volumes of crude oil. The \$1.6 million increase in operating expenses included higher employee costs and professional fees.

FUTURE IMPACT. The improvement in Refining and Marketing results have been due in part to the Company's marketing program to sell a larger portion of its refinery production within the core Alaska market. In addition, favorable summer and fall weather conditions in Alaska increased the demand for the Company's in-state sales during the 1997 Period. In early October 1997, the Company completed an expansion of its refinery hydrocracker unit, which

increases the unit's capacity by approximately 25% to 12,500 barrels per day and enables the Company to produce more jet fuel. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of \$19 million with a projected payback period of two years and is expected to favorably impact this segment's results beginning in the fourth quarter of 1997. The Company is also expanding its Alaskan retail operations with the construction of new outlets and remodeling of existing outlets. With respect to crude oil supply, beginning in October 1997, a subsidiary of the Company has contracts to purchase all of the approximately 34,000 barrels per day of Cook Inlet production for various periods of more than one year. In the 1997 Period, the Company processed approximately 9,300 barrels per day of Cook Inlet crude, or 19% of the refinery's throughput. The increase in Cook Inlet crude oil as a refinery feedstock will enable the Company to

*Sells Crude to
Subsidiary
Trio to P.O.*

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produce higher-valued products. Although the aforementioned initiatives are expected to improve the fundamental earnings potential of this segment, future profitability of this segment will continue to be influenced by market conditions, particularly as these conditions influence costs of crude oil relative to prices received for sales of refined products, and other additional factors that are beyond the control of the Company.

<TABLE>

<CAPTION>

EXPLORATION AND PRODUCTION

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
(Dollars in millions except per unit amounts)				
<S>	<C>	<C>	<C>	<C>
U.S. <FN1> <FN2>:				
Gross Operating Revenues	\$ 15.9	23.0	53.3	73.4
Other Income (primarily retroactive severance tax refunds)	-	-	1.9	5.0
Production Costs	1.5	1.3	5.0	3.8
Administrative Support and Other Operating Expenses . . .	.6	.2	1.7	2.2
Depreciation, Depletion and Amortization	7.0	6.2	22.2	18.9
Operating Profit - U.S.	6.8	15.3	26.3	53.5
BOLIVIA:				
Gross Operating Revenues	3.8	3.4	8.4	10.5
Other Income (related to collection of a receivable) . . .	-	-	2.2	-
Production Costs	.3	.2	.7	.6
Administrative Support and Other Operating Expenses . . .	.5	.6	1.3	2.1

Depreciation, Depletion and Amortization.	.5	.4	1.0	1.0
	-----	-----	-----	-----
Operating Profit - Bolivia	2.5	2.2	7.6	6.8
	-----	-----	-----	-----
TOTAL OPERATING PROFIT - EXPLORATION AND PRODUCTION. . . . \$	9.3	17.5	33.9	60.3
	=====	=====	=====	=====

U.S.:

Average Daily Net Production:				
Natural gas (Mcf)	79,683	80,612	86,317	88,723
Oil (barrels)	93	39	119	15
Average Prices:				
Natural gas (\$/Mcf) -				
Spot market<FN3> \$	2.01	1.71	2.08	1.77
Average<FN2> \$	2.01	2.92	2.08	2.85
Oil (\$/barrel) \$	18.23	20.93	19.44	20.59
Average Operating Expenses (\$/Mcfe) -				
Lease operating expenses \$	.21	.14	.18	.12
Severance taxes.	-	.04	.03	.04
	-----	-----	-----	-----
Total Production Costs.	.21	.18	.21	.16
Administrative support	.09	.01	.07	.08
	-----	-----	-----	-----
Total Operating Expenses. \$	.30	.19	.28	.24
	=====	=====	=====	=====
Depletion (\$/Mcfe) \$	.93	.82	.92	.77
	=====	=====	=====	=====
Capital Expenditures. \$	16.3	11.7	32.5	27.1
	=====	=====	=====	=====

BOLIVIA:

Average Daily Net Production:				
Natural gas (Mcf)	26,856	20,945	18,452	21,355
Condensate (barrels)	760	605	529	611
Average Prices:				
Natural gas (\$/Mcf) \$				
	1.13	1.31	1.20	1.33
Condensate (\$/barrel) \$				
	15.00	16.92	16.23	16.50
Average Operating Expenses (\$/Mcfe) -				
Production costs \$	.10	.11	.11	.10
Value-added taxes.	-	.08	-	.07
Administrative support	.20	.24	.25	.24
	-----	-----	-----	-----
Total Operating Expenses. \$	.30	.43	.36	.41
	=====	=====	=====	=====
Depletion (\$/Mcfe) \$	.19	.17	.18	.15
	=====	=====	=====	=====
Capital Expenditures. \$	20.0	.8	26.0	5.7

=====

<FN>

<FN1> Represents the Company's U.S. oil and gas operations combined with gas transportation activities.

<FN2> Results for 1996 included revenues from above-market pricing provisions of a contract with Tennessee Gas which was terminated effective October 1, 1996. Operating profit for the three and nine months ended September 30, 1996 included \$8.5 million and \$24.6 million, respectively, for the excess of these contract prices over spot market prices. Net natural

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gas production sold under the contract averaged approximately 14 Mmcf per day for both the three months and nine months ended September 30, 1996.

<FN3> Includes effects of the Company's natural gas commodity price agreements which amounted to a loss of \$.19 per Mcf for the three months ended September 30, 1996, and losses of \$.06 per Mcf and \$.15 per Mcf for the nine months ended September 30, 1997 and 1996, respectively.

<FN4> Mcf is defined as one thousand cubic feet; Mcfe is defined as net equivalent one thousand cubic feet.

</TABLE>

EXPLORATION AND PRODUCTION - U. S.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$6.8 million from the Company's U.S. operations in the 1997 Quarter compares to operating profit of \$15.3 million in the 1996 Quarter. The 1996 Quarter included revenues from the sale of natural gas at above-market prices under a contract with Tennessee Gas. The excess of these contract prices over spot market prices contributed approximately \$8.5 million to operating profit in the 1996 Quarter. When excluding the incremental value of the Tennessee Gas contract from the 1996 Quarter, operating profit from the Company's U.S. operations for the 1997 Quarter would be relatively unchanged as total production volumes remained flat during both quarters and increases in spot market natural gas prices were offset by increased depreciation and depletion and operating expenses.

Prices realized by the Company on spot market natural gas production increased to \$2.01 per Mcf in the 1997 Quarter from \$1.71 per Mcf in the 1996 Quarter. On a weighted-average basis, the Company's natural gas sales price was \$2.92 per Mcf in the 1996 Quarter due to sales under the Tennessee Gas contract. The Company's production averaged 80.2 million cubic feet equivalents ("Mmcfe") per day in the 1997 Quarter compared to 80.8 Mmcfe per day in the 1996 Quarter. This decrease in the Company's production consisted of a 14.0 million cubic feet ("Mmcf") per day decline from the Bob West Field partially offset by a 13.4 Mmcfe per day production increase from other U.S. fields. The Company's production outside of the Bob West Field rose to 23% of total production during the 1997 Quarter, as compared to 6% in the 1996 Quarter. In September 1997, production began from the Company's interest in the Vinegarone East Field in Val

Verde Basin of Southwest Texas at an initial flow rate of approximately 12 Mmcf per day gross (8.6 Mmcf per day net). Drilling is underway on two development wells in this field. In addition, the Cuellar 1 well, which was discovered during the 1997 Quarter in the Wilcox Trend of South Texas, began production in October 1997 at 8.0 Mmcf per day gross (6.0 Mmcf per day net). The Company's net U.S. production reached 90 Mmcf per day in late October 1997.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$.2 million in the 1997 Quarter due primarily to higher per-unit lease operating expenses from the Company's newer fields. Depreciation and depletion increased by \$.8 million, or 13%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuation in the prices of natural gas in the spot market. During the 1996 Quarter, the Company used such agreements to set the price of 38% of the natural gas production that it sold in the spot market and recognized a loss of \$1.2 million (\$.19 per Mcf) related to these price agreements. The Company did not have any such transactions during the 1997 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$26.3 million from the Company's U.S. operations in the 1997 Period compares to \$53.5 million in the 1996 Period. Comparability between these periods was impacted by certain significant items. The 1996 Period included operating profit of \$24.6 million from the excess of Tennessee Gas contract prices over spot market prices. Results of operations in 1997 and future years will no longer include above-market revenues from this contract which was terminated effective October 1, 1996. Operating profit also included retroactive severance tax refunds of \$1.8 million and \$5.0 million in the 1997 and 1996 Periods, respectively. Excluding the incremental value of the Tennessee Gas contract and retroactive severance tax refunds, operating profit from the Company's U.S. operations would have been \$24.5 million in the 1997 Period compared to \$23.9 million in the 1996 Period. The resulting increase of \$.6 million was primarily attributable to higher spot market prices for sales of natural gas partially offset by higher depreciation and depletion.

Prices realized by the Company on its spot natural gas production increased 18% to \$2.08 per Mcf in the 1997 Period from \$1.77 per Mcf in the 1996 Period. The increase in average spot market prices was attributable in part to unusually high prices received during January and February when there was unusually cold weather combined with below-normal natural gas storage levels. On a weighted-average basis, the Company's natural

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gas sales price was \$2.85 per Mcf in the 1996 Period due to sales under the

Tennessee Gas contract. The Company's production averaged 87.0 Mmcfe per day in the 1997 Period, a decrease of 1.8 Mmcfe per day from the 1996 Period. This decrease in the Company's production consisted of a 13.9 Mmcfe per day decline from the Bob West Field partially offset by a 12.1 Mmcfe per day increase from other U.S. fields. Production from the Bob West Field, which accounted for 95% of the Company's total U.S. production in the 1996 Period, was reduced to 81% in the 1997 Period.

Gross operating revenues from the Company's U.S. operations, after excluding amounts related to Tennessee Gas, increased due to the higher spot market prices. Production costs increased by \$1.2 million during the 1997 Period due to higher per-unit lease operating expenses from the Company's newer fields. Administrative support and other operating expenses decreased by \$.5 million. Depreciation and depletion increased by \$3.3 million, or 17%, due to a higher depletion rate.

From time to time, the Company enters into commodity price agreements to reduce the risk caused by fluctuations in the prices of natural gas in the spot market. In addition, from time to time the Company has entered into price agreements with collars, under which no payments will be made by either party unless the price falls below a designated floor price or above a designated ceiling price, at which time the Company receives or pays the difference, respectively. During the 1997 and 1996 Periods, the Company used such agreements to set the price of 11% and 37%, respectively, of the natural gas production that it sold in the spot market. During the 1997 and 1996 Periods, the Company realized losses of \$1.6 million (\$.06 per Mcf) and \$2.9 million (\$.15 per Mcf), respectively, from these price agreements. At September 30, 1997, the Company has no remaining price agreements outstanding for the year.

EXPLORATION AND PRODUCTION - BOLIVIA

HYDROCARBONS LAW. In 1996, a new Hydrocarbons Law was passed by the Bolivian government that significantly impacts the Company's operations in Bolivia. The new law, among other matters, granted the Company the option to convert its Contracts of Operation to new Shared Risk Contracts. On November 6, 1997, the Company completed the conversion of its Contracts of Operation for Block 18 and Block 20 into four Shared Risk Contracts. The new contracts have an effective date of July 29, 1996 and extend the Company's term of operation, provide more favorable acreage relinquishment terms and provide for a more favorable fiscal regime of royalties and taxes. The new contract for Block 18 is extended to the year 2017. The new contracts for Block 20 are extended to the year 2029 for Block 20-West and Block 20-East, which are in the exploration phase, and to the year 2018 for Block 20-Los Suris that is in the development phase.

FARMOUT. A farmout agreement executed June 19, 1997, between the Company and Total Exploration Production Bolivie, S.A. ("Total"), an affiliate of Total S.A., became effective on a portion of Block 20-West on November 6, 1997. Pursuant to the farmout agreement, Total established a financial guarantee to

the Bolivian government to guarantee the performance of exploration work on Block 20-West. Under the farmout agreement, Total has the right to drill, at its sole cost, two exploratory wells to earn a 75 percent interest in the farmout area which consists of 315,000 acres of Block 20-West. The assignment of interest by the Company to Total, which is subject to reversion if Total does not earn the interest, has been approved by the Bolivian government and is expected to become effective in the fourth quarter of 1997. It is anticipated that Total will spud the first well by mid-1998.

YPFB AND YPF CONTRACT. The Company's Bolivian natural gas production has been sold to Yacimientos Petroliferos Fiscales Bolivianos ("YPFB"), which in turn sells the natural gas to Yacimientos Petroliferos Fiscales, SA ("YPF"), a publicly-held company based in Argentina. Currently, the Company's sales of natural gas production is based on the volume and pricing terms in the contract between YPFB and YPF. The contract to sell gas to YPF expired March 31, 1997 and a contract extension was signed effective April 1, 1997 extending the contract term two years to March 31, 1999 with an option to extend the contract a maximum of one additional year if the pipeline being constructed from Bolivia to Brazil is not complete. In the contract extension, YPF negotiated an 11% reduction in the minimum contract volume it is required to import from Bolivia, which in turn resulted in a corresponding 11% reduction of Tesoro's minimum contract volume.

ACCESS TO NEW MARKETS. A lack of market access has constrained natural gas production in Bolivia. Preliminary work on a new 1,900-mile pipeline that will link Bolivia's gas reserves with markets in Brazil has begun and the pipeline is expected to be operational in early 1999.

THREE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$2.5 million from the Company's Bolivian operations in the 1997 Quarter compares to

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operating profit of \$2.2 million in the 1996 Quarter. With the Company's purchase of Zapata's interests in Block 18 and Block 20 in July 1997, the Company now holds a 100% interest in both blocks, subject to the farmout agreement with Total (see Note 2 of Notes to Condensed Consolidated Financial Statements). Beginning in the 1997 Quarter, the Company's net share of production from Block 18 increased by approximately 33% as a result of this purchase. Block 20 is currently shut-in waiting on the construction of the pipeline to Brazil, which is expected to be operational in early 1999. Natural gas prices for Bolivian production fell to \$1.13 per Mcf in the 1997 Quarter, a 14% drop from the 1996 Quarter.

NINE MONTHS ENDED SEPTEMBER 30, 1997 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1996. Operating profit of \$7.6 million from the Company's Bolivian

operations in the 1997 Period compares to operating profit of \$6.8 million in the 1996 Period. The 1997 Period included income of \$2.2 million related to the collection of a receivable for prior years production. Excluding this income, operating profit would have decreased by \$1.4 million as production of natural gas and condensate fell by 14%. As discussed above, the Company's production rose during the 1997 Quarter due to the purchase of the Zapata interests in July 1997 which will also benefit future periods. However, earlier in the year, the Company's Bolivian natural gas production was lower due to a reduction in minimum takes under the new contract between YPFB and YPF and also due to constraints arising from repairs to a non-Company-owned pipeline that transports gas from Bolivia to Argentina. A replacement pipeline is now operational, which has restored full capacity. During the 1996 Period, production was higher due to requests from YPFB for additional production from the Company to meet export specifications. Natural gas prices declined to \$1.20 per Mcf in the 1997 Period compared to \$1.33 per Mcf in the 1996 Period. Administrative support and other operating expenses decreased by \$.8 million in the 1997 Period due primarily to the reduced production levels.

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MARINE SERVICES

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in millions)	1997	1996	1997	1996
	----	----	----	----
<S>	<C>	<C>	<C>	<C>
Gross Operating Revenues:				
Fuels	\$ 25.2	26.0	77.6	70.4
Lubricants and other.	4.2	4.1	12.3	10.9
Services.	3.1	2.6	8.4	6.2
	----	----	----	----
Gross Operating Revenues	32.5	32.7	98.3	87.5
Costs of Sales	22.9	24.5	72.6	66.7
	----	----	----	----
Gross Profit	9.6	8.2	25.7	20.8
Operating Expenses and Other	6.5	5.8	20.4	15.4
Depreciation and Amortization.	.4	.4	1.2	.9
	----	----	----	----
Operating Profit	\$ 2.7	2.0	4.1	4.5
	=====	=====	=====	=====
Sales Volumes (millions of gallons):				
Fuels, primarily diesel	39.1	37.8	116.2	107.4
Lubricants.	.7	.7	2.0	1.9
Capital Expenditures	\$ 2.0	1.2	5.3	6.2

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For the 1997 Quarter, gross operating revenues declined by \$.2 million due primarily to lower fuel sales prices partly offset by increased fuel volumes. The \$1.6 million decrease in cost of sales correlates to these lower fuel market prices. The 19% increase in service revenues was associated with the increased rig activity in the Gulf of Mexico and the Company's focus to serve these customers. The improvement of \$1.4 million in gross profit was partly offset by higher operating expenses associated with the increased sales volumes and service revenues.

For the 1997 Period, gross operating revenues increased by \$10.8 million, with an 11% increase in fuels and lubricants revenues and a 35% increase in service revenues. These increases were mainly due to added locations and associated volumes stemming from an acquisition consummated in February 1996 together with internal growth initiatives. Costs of sales during the 1997 Period increased due to the higher volumes and also included a \$.7 million charge associated with inventory valuations as market prices declined from year-end levels. The improvement of \$4.9 million in gross profit during the 1997 Period was offset by higher operating and other expenses associated with the increased activity and upgrades to facilities and services.

The Marine Services segment's business is largely dependent upon the volume of oil and gas drilling, workover, construction and seismic activity in the Gulf of Mexico.

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GENERAL AND ADMINISTRATIVE

General and administrative expense increased by \$.3 million and \$.6 million during the 1997 Quarter and Period, respectively. These increases were primarily due to higher employee costs partially offset by reduced professional fees and insurance costs.

INTEREST EXPENSE AND INTEREST INCOME

Interest expense decreased by \$2.6 million and \$7.5 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to the Company's redemption of \$74.1 million of public debt in November 1996 which has resulted in interest expense savings of approximately 60% in the 1997 Quarter and Period.

Interest income decreased by \$6.9 million and \$6.2 million during the 1997 Quarter and Period, respectively. The 1996 Quarter and Period included interest of approximately \$7 million received from Tennessee Gas in conjunction with the collection of a receivable which resulted from underpayment for natural gas sold

in prior periods. The 1997 Period included interest income of approximately \$.4 million related to the collection of a Bolivia receivable.

OTHER EXPENSE, NET

For the 1997 Period, other expense decreased by \$5.3 million primarily due to charges incurred in the prior year period for shareholder consent solicitation costs of \$2.3 million, which was resolved in April 1996, together with a write-off of deferred financing costs and employee termination costs with no material comparable costs recorded in the current period.

INCOME TAX PROVISION

Income taxes decreased by \$2.2 million and \$2.8 million during the 1997 Quarter and Period, respectively. These decreases were primarily due to lower earnings.

IMPACT OF CHANGING PRICES

The Company's operating results and cash flows are sensitive to the volatile changes in energy prices. Major shifts in the cost of crude oil used for refinery feedstocks and the price of refined products can result in a change in margin from the Refining and Marketing operations, as prices received for refined products may or may not keep pace with changes in crude oil costs. These energy prices, together with volume levels, also determine the carrying value of crude oil and refined product inventory. The Company uses the last-in, first-out ("LIFO") method of accounting for inventories of crude oil and U.S. wholesale refined products. This method results in inventory carrying amounts that are less likely to represent current values and in costs of sales which more closely represent current costs.

Likewise, changes in natural gas, condensate and oil prices impact revenues and the present value of estimated future net revenues and cash flows from the Company's Exploration and Production operations. The Company may increase or decrease its production in response to market conditions. The carrying value of oil and natural gas assets may be subject to noncash writedowns based on changes in natural gas prices and other determining factors.

Changes in natural gas prices also influence the level of drilling activity in the Gulf of Mexico. The Company's Marine Services operation, whose customers include offshore drilling contractors and related industries, could be impacted by significant fluctuations in natural gas prices. The Company's Marine Services segment uses the first-in, first-out ("FIFO") method of accounting for its inventories of fuel. Changes in fuel prices can significantly impact inventory valuations and costs of sales in this segment.

CAPITAL RESOURCES AND LIQUIDITY

OVERVIEW

The Company's primary sources of liquidity are its cash and cash equivalents, internal cash generation and external financing. During the first nine months of 1997, the Company made capital expenditures exceeding \$95 million, which were funded through a combination of cash flows from operations of \$71 million, external financing of \$16 million and available cash balances. Subsequently, in October 1997, the Company obtained a \$16.2 million term loan to finance the expansion of the refinery hydrocracker unit (see Note 3 of Notes to Condensed Consolidated Financial Statements). At September 30, 1997, the Company's debt-to-capitalization ratio was 22% which enhances the Company's ability to access capital markets.

The Company is focused on its strategic plans to make operational improvements and continues to assess its asset base in order to maximize returns and develop full value through strategic diversification and acquisitions in all of its operating segments. This ongoing assessment includes, in the Exploration and Production segment, evaluating ways in which the Company could diversify its oil and gas reserve base and offset the impact of declining production through domestic development, exploration and acquisition outside of the Bob West Field. In the Refining and Marketing segment, the Company has been engaged in studies to improve profitability and has also evaluated possible joint ventures, strategic alliances or business combinations; such evaluations have not resulted in any significant transaction but operating strategies have been implemented to optimize the product and feedstock slates, improve efficiencies and reliability, and expand marketing to increase placement of products in Alaska. In the Marine Services segment, the Company continues to pursue opportunities for expansion as well as optimizing existing operations.

The Company operates in an environment where its liquidity and capital resources are impacted by changes in the supply of and demand for crude oil, natural gas and refined petroleum products, market uncertainty and a variety of additional risks that are beyond the control of the Company. These risks include, among others, the level of consumer product demand, weather conditions, the proximity of the Company's natural gas reserves to pipelines, the capacities of such pipelines, fluctuations in seasonal demand, governmental regulations, the price and availability of alternative fuels and overall market and economic conditions. The Company's future capital expenditures as well as borrowings under its credit arrangements and other sources of capital will be affected by these conditions.

STOCK REPURCHASE PROGRAM

On May 7, 1997, the Company's Board of Directors authorized the repurchase of up to 3 million shares (approximately 11% of the current outstanding shares) of Tesoro Common Stock in a buyback program that will extend through the end of

1998. Under the program, subject to certain conditions, the Company may repurchase from time to time Tesoro Common Stock in the open market and through privately negotiated transactions. Purchases will depend on price, market conditions and other factors and will be made primarily from cash flows. The repurchased Common Stock is accounted for as treasury stock and may be used for employee benefit plan requirements and other corporate purposes. Repurchases of Common Stock are subject to the restricted payments provision of the Credit Facility as described below.

CREDIT ARRANGEMENTS

The Company has financing and credit arrangements with a consortium of nine banks under a corporate revolving credit agreement ("Credit Facility") which provides total commitments of \$150 million. The Credit Facility, which extends through April 2000, provides for cash borrowings up to \$100 million and issuance of letters of credit, subject to a borrowing base (which was approximately \$147 million at September 30, 1997). The Company, at its option, has currently activated total commitments of \$100 million. Outstanding obligations under the Credit Facility are secured by liens on substantially all of the Company's trade accounts receivable and product inventory and by mortgages on the Company's refinery and South Texas natural gas reserves. Under the terms of the Credit Facility, the Company is required to maintain specified levels of consolidated working capital, tangible net worth, cash flow and interest coverage. Among other matters, the Credit Facility contains covenants which limit the incurrence of additional indebtedness and restricted payments. An amendment to the Credit Facility, which was negotiated in September 1997, reduces interest rates and certain fees, increases the Company's borrowing base and makes certain covenants less restrictive. Additionally, the Company is now

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permitted to utilize unsecured letters of credit outside of the Credit Facility up to \$40 million (none outstanding at September 30, 1997). Under the Credit Facility, the Company had letters of credit of \$33.9 million, primarily for royalty crude oil purchases from the State of Alaska, and cash borrowings of \$11.9 million outstanding at September 30, 1997.

The terms of the Credit Facility allow for open market stock repurchases and the payment of cash dividends subject to a cumulative amount available for restricted payments (defined as the difference of (i) the sum since December 31, 1995, of (a) \$5 million and (b) 50% of consolidated net earnings of the Company in any calendar year and (ii) any restricted payments made since June 1996). At September 30, 1997, the cumulative amount available for restricted payments was approximately \$54 million. Annually, however, the aggregate of open market stock repurchases and cash dividends cannot exceed a maximum of \$5 million. In addition, the Credit Facility permits the Company to repurchase a limited amount of Common Stock up to \$10 million annually, specifically for oddlot buyback

programs and employee benefit or compensation plans. While the Board of Directors has no present plans to pay dividends, from time to time the Board of Directors reevaluates the feasibility of declaring future dividends.

In addition to the Credit Facility, a subsidiary of the Company has a three-year line of credit with a bank which provides up to \$10 million for the purchase of real estate and equipment for the Company's Marine Services segment at the bank's prime rate. The loan facility is not guaranteed by the Company and is secured only by such real estate and equipment that are financed. Beginning in March 1998, credit availability is reduced quarterly by 6.667%. At September 30, 1997, \$ 4.8 million was outstanding under the loan facility.

In early October 1997, the Company completed an expansion of the hydrocracker unit at its Alaska refinery. The expansion, together with the addition of a new, high-yield jet fuel catalyst, has an estimated cost of approximately \$19 million and is expected to improve the Company's refinery feedstock and product slate beginning in the fourth quarter of 1997. In October 1997, the National Bank of Alaska ("NBA") and the Alaska Industrial Development and Export Authority ("AIDEA"), under a loan agreement ("Hydrocracker Loan") entered into between the Company and NBA, provided a \$16.2 million loan to the Company towards the cost of the hydrocracker expansion. The Hydrocracker Loan matures on or before April 1, 2005 and is secured by a second lien on the refinery. Under the terms of the Hydrocracker Loan, the Company is required to maintain specified levels of working capital and tangible net worth. See Note 3 of Notes to Condensed Consolidated Financial Statements.

CAPITAL SPENDING

During the first nine months of 1997, the Company's capital expenditures totaled \$95 million which were financed with available cash reserves, internally-generated cash flows from operations and external financing. In addition, the Company has obtained outside financing, as discussed above, for expansion of the refinery hydrocracker unit. Although capital expenditures for the remainder of the year had been projected to reach \$65 million, actual capital spending will be less due to a number of factors, including the extent to which properties are acquired and the timing of capital projects. Capital expenditures for the remainder of the year are expected to be funded by cash flows from operations and external borrowings under the Company's credit arrangements.

The Exploration and Production segment accounts for \$101 million of the projected capital expenditures, with \$71 million planned for U.S. activities and \$30 million in Bolivia. Planned U.S. expenditures include \$22 million for property acquisitions; \$17 million for development drilling (participation in 16 wells), field facilities and workovers; \$13 million for leasehold, geological and geophysical; and \$19 million for exploratory drilling (participation in 14 wells). For the first nine months of 1997, actual U.S. expenditures were \$32 million, principally for participation in the drilling of five development wells

(all completed) and nine exploratory wells (seven completed). In Bolivia, projected capital expenditures of \$30 million for the year included an increase for the purchase of additional contract interests in July 1997 (see Note 2 of Notes to Condensed Consolidated Financial Statements). The projection in Bolivia includes \$3 million for one exploratory well and \$2 million for workovers and field facilities, with the remainder planned for three-dimensional seismic. Capital spending for the first nine months of 1997 totaled \$26 million in Bolivia, primarily for the purchase of additional contract interests, exploratory drilling, seismic activity and workovers. Although the Company continues to pursue exploratory, development and acquisition opportunities, as discussed above, actual capital expenditures for the remainder of the year may vary from projections.

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Capital spending for the Refining and Marketing segment is projected to be \$50 million for the year, including costs for the refinery hydrocracker expansion and a multi-year capital program to improve marketing operations. During the first nine months of 1997, the Refining and Marketing segment had spent approximately \$31 million towards capital projects.

In the Marine Services segment, capital spending for 1997 is currently projected at \$8 million, a \$21 million reduction from the original budget. This projection, of which \$5 million was spent during the first nine months of 1997, is now primarily directed towards expansion and improvement of operations along the Gulf of Mexico rather than acquisitions.

CASH FLOWS

Components of the Company's cash flows are set forth below (in millions):

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Nine Months Ended
September 30,

1997 1996

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Cash Flows From (Used In):

Operating Activities	\$	71.1	148.4
Investing Activities		(98.2)	(57.0)
Financing Activities		11.7	(1.8)
		-----	-----
Increase (Decrease) in Cash and Cash Equivalents	\$	(15.4)	89.6
		=====	=====

</TABLE>

Operating cash flows of \$71 million during the 1997 Period included a \$46 million decrease in receivables due in part to collections related to high product and crude oil sales volumes at 1996 year-end and to a Bolivian receivable representing production sold in prior years, partially offset by income tax and other payments. The 1996 Period operating cash flows of \$148 million included a \$67.5 million receipt from Tennessee Gas and reduced working capital requirements. Net cash used in investing activities of \$98 million during the 1997 Period included capital expenditures of \$58 million for the Company's Exploration and Production activities, \$31 million for Refining and Marketing operations and \$5 million for Marine Services. Net cash from financing activities during the 1997 Period included borrowings of \$16 million under revolving credit facilities partially offset by payments of other long-term debt and purchases of treasury stock. At September 30, 1997, the Company's net working capital totaled \$76 million, which included cash and cash equivalents of \$7 million.

ENVIRONMENTAL

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, which change frequently, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites or install additional controls or other modifications or changes in use for certain emission sources. The Company is currently involved in remedial responses and has incurred cleanup expenditures associated with environmental matters at a number of sites, including certain of its own properties. At September 30, 1997, the Company's accruals for environmental expenses amounted to \$8.7 million, which included a noncurrent liability of \$3.1 million for remediation of KPL's properties that has been funded by the former owners of KPL through a restricted escrow deposit. Based on currently available information, including the participation of other parties or former owners in remediation actions, the Company believes these accruals are adequate. In addition, to comply with environmental laws and regulations, the Company anticipates that it will make capital improvements of approximately \$3 million in 1997 and \$8 million in 1998. The Company also expects to spend approximately \$6 million by the year 2002 for secondary containment systems for existing storage tanks in Alaska.

Conditions that require additional expenditures may exist for various Company sites, including, but not limited to, the Company's refinery, retail gasoline outlets (current and closed locations) and petroleum product terminals, and for compliance with the Clean Air Act. The amount of such future expenditures cannot currently be determined by the Company. For further information on environmental contingencies, see Note 4 of Notes to Condensed Consolidated Financial Statements.