12146 HOUSE JUDICIARY

"a relationship of mutual benefits." Once the oil companies entered into the lease, they were no longer free to make decisions based on their unilateral economic best interests. Instead, the law is clear that the companies have an obligation to make decisions, including investment decisions, based on the mutual interests of the oil companies and the state as landowner. Thus, in making decisions, the producers must demonstrate due regard for the interests of the state as the royalty owner. He offered that to conceptualize this is to appreciate that the oil companies don't have any obligation to treat the state better than they treat themselves, but they should never treat the state worse.

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MR. HOSIE pointed out that in many situations the economic interests of the oil companies and the state are aligned, such as that everyone benefits from higher oil prices. He stated that the one key area in which the economic interests of the oil companies tended to verge from those of the landowner is related to ongoing or future development and the obligation to spend money. He opined that a landowner almost invariably wants the field developed in production immediately since the landowner benefits through royalty share of the hydrocarbon sale. Sometimes the oil companies may not want to develop a field immediately, due to a cash problem or the opportunity to put investment dollars in more lucrative projects elsewhere in the world. For example, if an oil company's return is 40 percent in Qatar and 20 percent in Alaska, it would rather make the investment in Qatar and, in doing so, act as a rational economic business. However, under existing oil leases the oil companies are not free to make decisions on their interest alone and must consider the state, their partner.

MR. HOSIE offered that the courts have addressed this inherent conflict through a court rule, which is straightforward, such that if a given project in a given field is economic, based on its own merits, the oil companies have an obligation to move forward. He asked, "Why is that?" He answered, "Because that's the deal they made to get the lease. When they came to Alaska 45 years ago, they promised to use their expertise and their money to develop the field." Thus, he explained, the courts review the question of whether additional development dollars had to be spent and weigh in that if it is economic and reasonably profitable, the oil companies have an obligation to move forward. He noted that given the producers' duty, the Alaska gasline or any Alaska project does not have to be the most profitable project available to the producers. The state is not in competition for the development dollars given the pre-existing lease obligation. He opined that if the state was attempting to initially attract the oil industry, it would be a different question. Under Alaska leases, the oil companies agree to take risks, which is why the companies are entitled to 87.5 percent [of the value of the oil and gas] without any guarantee of profitability.

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MR. HOSIE said:

> And so, the extent that there's a notion that they're entitled to a reduced risk deal in Alaska that is contrary to the obligations they undertook so many years ago. ... What's happened in Alaska? Well, many years ago the state went to the producers and said, "We'd like a gasline." And the producers said, "We'd like a gasline, too, but we've looked at it and we don't think it's economic without substantial concessions - financial concessions from the state."

Since they did not find it economic, absent substantial economic concessions, the oil industry effectively said, "We don't think it's economic." That led to the Stranded Gas Act, the protracted negotiations, [and] the contract that was not approved several years ago.

When that contract failed to come to fruition, the state was left with three alternatives, hree options, none good. The first option is that they could have simply accepted the producers' insistence for concessions and "sweeten the pot," ... but the state was not willing to do that at the time. The second option is that they could have said, "Well, we will live with your decisions on timing, producers. You tell us when you're ready to build, and we'll wait patiently until you are ready to go forward, for whatever complex of your own reasons might project when it's time to pull the trigger . And since the state wants a gasline, needs the jobs, wants the resource produced - turned into money - that wasn't a very palatable alternative either. The third option would have been to sue the producers to prove the gasline economic and try to compel them to build it. ... Of the three options that was, I think, far and away, the least appealing. You never want to compel someone to be a partner of yours, and a litigation to try to prove a gasline economic would have been extremely protracted, maybe as long as a decade, and it would have given the producers the very thing that some felt they wanted, which was delay. the notion of suing them to try to make a gasline a reality really was a nonstarter from the get-go.

And so, this administration found a fourth way, and that's AGIA. Essentially they said, "Well, you know, if the producers don't find the line economic, if they don't want to build it, let's find somebody who might think about it differently, who might say, "You know what, we're willing to build that line." And they found that party, and of course it's TransCanada.

Now, the TransCanada bid is - in terms of the "duty to develop" analysis - really a game changer. It really changes everything, and here's why: It moved the entire argument with the producers about whether they think the gasline is economic. It doesn't matter what their internal hurdle rates are. It doesn't matter, for instance, that Exxon - it was reported in the Wall Street Journal last Friday has an upstream internal hurdle rate of more than 35 percent. All those questions are moot because there is a third party willing to spend the money and build the pipeline. And that changes everything.

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MR. HOSIE concluded that the "duty to develop" question boils down to whether, if TransCanada goes forward, it's producers can say they really don't want a third party to own or operate the pipeline, that they will not tender gas, thereby essentially stopping the project. In other words, Mr. Hosie said, the question is whether the producers have veto power over a third power pipeline by refusing the tender their gas. He stated, "The answer is: under the duties they have under the leases - no, so long as they have the opportunity to tender to TransCanada on reasonably commercial terms." He said ExxonMobil Corporation has already recognized that it would tender the gas to TransCanada on reasonably commercial terms, and he said he thinks the company has stated as much because "that is its obligation under its leases." He stated that that is equally true for ConocoPhillips Alaska, Inc. and the other North Slope producers.

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SENATOR WAGONER offered that the legislature has heard a lot of talk about a gas treatment plant, who should pay for it, et cetera. He inquired as to whether it is customary industry practice for producers to deliver gas that is marketable gas and meets all pipeline gas quality specifications prior to delivering that gas to the transporting pipeline.

SPENCER HOSIE answered yes.

4:01:21 PM

SENATOR WIELECHOWSKI offered that the legislature has heard a lot of discussion about instate gas, that an instate bullet line would not provide low-cost gas. He stated that what has happened in Cook Inlet is that producers or gas developers set the gas rate - for example, at Henry Hub. He related his understanding from Regulatory Commission of Alaska (RCA) he rings that the rate to produce the gas in Cook Inlet is about a dollar per million cubic feet (Mcf), but that the producers sell the gas at $6.80 per Mcf, which is nearly a 700 percent profit. He inquired as to whether the state can compel producers to provide low-cost gas.

MR. HOSIE answered that the state can take its gas in-kind and then could sell it at whatever price it elects. He noted that it is interesting that Senator Wielechowski referenced Cook Inlet since the producers in the Cook Inlet have publically stated that they are not making enough money from the sales levels at Cook Inlet to warrant future exploration and development. He opined that it is hard to believe this is true, given the figures Senator Wielechowski pointed out because these are older fields with the current sales realization. He opined that what has happened in Cook Inlet is essentially what has happened with the state in the Stranded Gas negotiations, which are negotiations that say, "We want you to make our economics better and, of course, conversely yours worse."

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REPRESENTATIVE GARA related his understanding that sophisticated companies - the major producers - are not going to tell the state that they are going to sell gas if they have an interest in building their own line or in blocking this gasline. He opined that it is in their corporate best interest not to advise the state affirmatively that it will sell its gas. He surmised that it could lead to litigation and at some point the producers might acquiesce and tell the state they will sell the gas. He further surmised that they would do so because they might not just lose the litigation, but may lose their leases worth possibly 20 billion dollars. He opined that they are "playing with fire by pushing this issue." Thus, he opined that if the state finds a pipeline project that it likes, it seems "smart to us not to flinch when the producers don't necessarily commit to publically selling their gas. It is our expectation that that's what they should be doing." He inquired as to whether that is a fair assessment and, if not, why it is not.

MR. HOSIE answered that Representative Gara makes an accurate statement. He stated that power means leverage and leverage means a better deal for the producers. He opined that one would not expect a party in a negotiation to inform another party of its future plans or true intent, if that knowledge would strengthen its opponent. He pointed out that this process is a negotiation and is all about money. He pointed out the importance of the state's understanding the preexisting legal relationship and the producers' preexisting obligations. He stated, "No party writes on a clean slate here. They have obligations. The state has rights." He pointed out that one of the state's rights is to insist that a project that is economic on its own terms moves forward. He opined that if the producers, after years of effort, simply decline to do so, without the state substantially "sweetening the pot," the state has every right to find a third party to do the very thing the producers have refused to do. And that third party is AGIA, he opined, and it raises questions, he said, "about what the proper rate of return is and how much money is sufficient and how much money is too much."

REPRESENTATIVE GARA related his understanding that if we dump everything else and just go [the producer's] way, at that point [the producers] have an incredible amount of leverage over the state to try to obtain tax concessions.

MR. HOSIE agreed that Representative Gara's assessment is correct. He opined that once the state has left only one party standing, the party - in this case the producers - would have enormous negotiation leverage. He further opined that what happened to the state in the Stranded Gas negotiations would happen again, with ever escalating requests for concessions.

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SENATOR BUNDE inquired as to the projected length of time litigation would last if litigation were to occur as a result of the producers' refusal to commit gas to the line or to commit to what the state would define as "what's reasonably profitable." Furthermore, he asked if Mr. Hosie could offer examples of how long suits have lasted elsewhere under similar circumstances.

MR. HOSIE answered that the precedent the state should hope to avoid is the ANS royalty case he previously mentioned which spanned a decade of active litigation. The state had the obligation to essentially prove all the economic underpinnings of the producers' business, including what it cost to produce and ship oil. He recalled that it became an enormously complicated factual fight and "that's their sandbox." He opined that that case represents exactly the fight the state would be engaged in if it were to sue the producers to say the state believes the pipeline is economic and wants the producers to move forward. That option would be least appealing because, after ll, if the producers' goal is to delay, then the state's suing them would give them exactly what they want.

MR. HOSIE described AGIA as a "game changer," because if AGIA is willing to spend its money and build a pipeline, to back the project with its equity, the only question for the producer is, "Can I tender in on commercially reasonable terms?" Mr. Hosie said that is a far simpler question than asking whether building the pipeline in the first place is economic or asking about the cost of fuel or the "widget costs" or deciding how many laborers to utilize. He estimated that "that piece of litigation, should the state ever get there, would be much shorter" perhaps two years rather than ten. That said, Mr. Hosie noted that the larger point is to try to avoid any litigation whatsoever and to try to get a pipeline built. "That," he opined, "is why this sort of public process ... is so tremendously beneficial, because it gives transparency to the process." He noted that Representative Gatto had asked the straightforward question: "Are the producers willing to ship over a third-party line?" He also noted that ExxonMobil Corporation was kind enough to answer, "Yes, we are." He added that the corporation said that because "that is their obligation." Once TransCanada is willing to bid, the question is whether gas can be shipped on reasonable terms, which Mr. Hosie opined is a much simpler and easier question to answer.

SENATOR BUNDE inquired as to whether another governmental agency, such as FERC would intervene in the event that there is not a commitment to ship [the gas] and the state doesn't want to sue.

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MR. HOSIE answered yes and offered that Mr. Van Fleet would address that question.

4:11:22 PM

SENATOR STEDMAN noted that it appears that BP and Conoco are moving forward with the Denali project - their version of a gasline. He related his understanding that the producers intend to spend up to $600 million and pre-apply with FERC. He inquired, "So, how does ... this play when it appears that we actually have two of the producers that are moving forward to build a line, versus all three of them just flat not showing up to build the line under your 'duty to produce'?"

MR. HOSIE offered that it represents a "wonderful development" for the state. He echoed Commissioner Irwin's comment that "competition is a wonderful thing." He opined that it the producers are serious, commit to deadlines, and move forward, that is a "good thing," because competition between two pipeline entrants can only benefit the state. He opined that the overarching question is whether the Denali project is real or is an attempt to derail AGIA. He said he does not think that anyone knows the answer to that question, but that it is a relevant one.

SENATOR STEDMAN recalled that Mr. Hosie mentioned the process that did result in a gasline. He pointed out that the legislature did not act on the matter and it did not move forward. He inquired as to whether that would "strengthen or weaken the producer's hand" especially if the state claims the producers are refusing to build the line when the legislature was the entity that "refused to bless that past agreement."

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MR. HOSIE responded that he thinks it would neither strengthen nor weaken the producers' position, since AGIA moved the question, and since the state is not trying to force the producers to build the gasline. He opined that the state has simply accepted the producers' word that [building the pipeline] is not economic and TransCanada is willing build it. He noted that the state can sidestep all those questions about whether it can compel the producers to come forward since TransCanada is willing to do the very thing that the producers have refused to do.

SENATOR STEDMAN inquired as to whether this process of "duty to produce" has ever gone forward before.

MR. HOSIE answered that it has not occurred in Alaska but has happened in the Lower 48, and some cases go back 50 years that ask the question as to when an oil producer has an obligation to move forward. He acknowledged that sometimes it is a small matter such as drilling a couple of development wells. However, he noted that it sometimes has been a matter of installing a line to connect a stranded field to a preexisting pipeline. He pointed out that the legal answer is always the same, which is as long as the project is reasonably economic and measured objectively, the producers have an obligation to proceed. However, he cautioned that he was not aware of any case in which a royalty owner sued producers to try to compel them to spend $30 billion. He opined that would be "a recipe for disaster." He offered that the "beauty of AGIA" is that the state has found someone willing [to build the gasline].

CHAIR HUGGINS offered that Mr. Hosie will be available tomorrow to answer questions.

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SENATOR DYSON related that he appreciates that the anti-trust implications will be covered. He recalled his conversations with FERC commissioners, who reminded him that this project is different than any other FERC reviews because Congress has acted and declared that it is in the national interest and in essence "must be done." He offered that the legislators have often heard the threat of delaying lawsuits. He inquired as to whether any venue could compel the shipping of gas while legal questions are still being decided. He recalled that Mr. Hosie said that a refusal to ship would be a breach of contract and far less extended and convoluted than other lawsuits. He further inquired as to whether that might be within the purview of FERC.

MR. HOSIE suggested that Mr. Van Fleet wo ld address that concern.

4:18:14 PM

MR. VAN FLEET, Shareholder, Greenburg Traurig, LLP, noted that several legislators, as well as Mr. Hosie, identified what are essentially the contract rights between a landowner and a producer who leases that land, although he noted that in this case, the landowner is the state, and the state has responsibilities to its citizens that make the issue much broader. He pointed out that the gasline creates a great deal of interest, including that of those in the Lower 48 who want gas to heat or cool their homes. He offered to speak about the broader public interest that is reflected in federal and state anti-trust laws and also federal legislation that addresses energy market manipulation.

MR. VAN FLEET shared his background practicing anti-trust law for 30 years. He stated that he has represented oil and gas companies and pipelines, and he has sued oil companies for withholding supply from the market. He noted he has defended [companies] and advised them on how to avoid anti-trust laws. He said, "Out of longevity, more than anything, I've been honored by my peers in the American Bar Association." He announced that he will be chair of the ABA anti-trust section in 2010. He referred to a slide labeled, "Standard Oil Monopoly," and he noted that ironically, 2010 is the one hundredth anniversary of the breakup of Standard Oil.

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MR. VAN FLEET referred to a slide labeled, "Anti trust Statutes." He explained that the anti-trust acts are the Sherman Act, Sections 1 and 2, which are enforced by the U.S. Attorney General acting through the Assistant Attorney General. The Federal Trade Commission Act (FTCA), Section 5, broadly prohibits all unfair means of competition. He offered that has been interpreted over many years to include violations of the anti-trust laws, and through that vehicle, the Federal Trade Commission (FTC), as well, has the authority to enforce the anti-trust laws of the United States. He pointed out that each state has its own anti-trust laws. The Alaska Restraint of Trade and Monopolies Act, contained in AS 45.50.562 - 596, is largely the same as Sections 1 and 2 of the Sherman Act, and is enforced by the state's attorney general. He further noted that the state's attorney general is empowered to act on behalf of the people of Alaska in bringing actions under federal anti-trust statutes. He said what that means is that Alaska's attorney general can act under state and federal anti-trust laws. Essentially, Section 1 and 2 of the Sherman Act, and AS 45, prohibit exclusionary conduct in order to maintain monopoly power and joint action by competitors to withhold supply from the market. He related as an example that at the turn of the century, Standard Oil controlled 90 percent of the petroleum in the United States. Standard Oil maintained its monopoly through severe exclusionary conduct, such as blowing up its competitors' pipelines.

MR. VAN FLEET referred to his next slide, which shows that in 1910, Standard Oil was broken up into the "Seven Sisters," and action affirmed by the U.S. Supreme Court. The Seven Sisters, as shown on the slide, include: Standard Oil of New Jersey (Esso), Royal Dutch Shell (Anglo-Dutch), Anglo-Persian Company (APOC), Standard Oil Com any of New York (Socony), Standard Oil of California (Socal), Gulf Oil, and Texaco. He related that Exxon and Mobil Oil merged to become ExxonMobil Corporation, and Chevron now includes Gulf Oil and Texaco. He pointed out that the reason to break up the monopoly was to turn it into competing businesses. Thus, instead of jointly deciding how much production ought to be on the market to control prices, companies compete with one another. He offered that with competition in place, if Esso kept its product off market, Mobil Oil could sell its product and make that money.

MR. VAN FLEET said:

> If there is an attractive pipeline that is there and available on commercially reasonable terms to ship North Slope gas to the Lower 48 or to Alberta to be

sold elsewhere, and the producers say "no," one might ask, "What's going on here?" And if they all do it together, one might ask, "What's going on here? Are they withholding this supply from the market because they're concerned about how that Alaska gas will affect the prices of natural gas and LNG in the Lower 48 and around the world where these three producers have significant ... gas and LNG holdings?" We do know this: they've looked at the question together

MR. VAN FLEET referred to his next slide, which shows a printout of the web site for ICF International, Inc , a highly respected, large consulting firm. He noted that the web site highlights the firm's projects to attract business.

MR. VAN FLEET referred to his next slide, which shows fuel market studies, and he cited a sentence at the lower portion of the slide, which read as follows:

> For producers on the Alaskan North Slope, ICF International evaluated the effect of Alaskan and MacKenzie Delta gas on U.S. and Canadian gas markets, prices, and pipeline flows.

MR. VAN FLEET said, "So, any of these anti trust enforcers might want to be asking if all the producers together are declining to commit gas to a viable pipeline, what's going on here?"

TIME STAMP

MR. VAN FLEET moved on to a series of slides labeled, "Market Manipulation Statutes," and said that in addition to the anti-trust laws, Congress, in recently years has passed specific market manipulation statutes. He said FERC, specifically empowered by the Energy Policy Act of 2005, was given enhanced enforcement powers over natural gas and electricity markets to identify and punish any attempts to manipulate those markets. He noted two recent cases which are pending, on appeal. In one case, FERC imposed a $200 million penalty, and it imposed a nearly $100 million penalty in another case, which is in addition to the requirement that the gas companies return the profits that were unjustly earned through market manipulation.

MR. VAN FLEET stated that the Energy Independence and Security act of 2007 prohibits any manipulative or deceptive device or contrivance in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates. It authorizes the Federal Trade Commission (FTC) to investigate those instances and to prescribe regulations.

MR. VAN FLEET referred to his next slide labeled, "FTC Advance Notice of Proposed Regulation." He pointed out that even though this deals with the liquid side of the petroleum market, a recent advance notice of proposed regulations gives some insight into how the FTC looks at these issues and how it might look at the liquids market, or perhaps the gas market, as to what it considers might constitute manipulation. He offered that this notice identifies "potential practices" that might constitute market manipulation. The FTC wants comments on the circumstances, if any, "under which a firm's decision regarding supplying a market - whether to reduce, increase, or maintain unchanged the amount it supplies should be considered manipulative or deceptive." He added, "So, in addition to being a potential anti-trust problem, they're considering that under their new powers to prohibit market manipulation."

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MR. VAN FLEET referred to his next slide labeled, "FTC Advance Notice of Proposed Regulation," and he explained that the FTC notes that regulated petroleum pipelines may not allow new shippers a share of a pipeline's capacity when historical shippers seek to transport more petroleum products than the pipeline is capable of transporting. Thus, the commission is currently seeking comments on whether pre-announcements that pipelines are approaching capacity straints might be a conduit for market manipulations or deceit. He added, "And it's interesting the commentary that they add to this particular question.

MR. VAN FLEET referred to his next slide labeled, "FTC on BP in Alaska North Slope," and offered that the FTC discusses its investigation of BP's acquisition of ARCO. He recalled that the big three producers in the North Slope used to be ExxonMobil Corporation, BP and ARCO. He noted that BP acquired ARCO and the FTC, in order to approve that merger, required BP to divest ARCO's North Slope holdings. The holdings were divested to Phillips, which is now Conoco Phillips. The FTC said, in its investigation, that "the commission had reason to believe that BP occasionally had exported ANS crude oil to the Far East in order to increase spot prices for ANS crude on the West Coast, and that BP benefitted from those higher spot prices because of its status as a merchant marketer." He opined that the kinds of things that are being discussed that the state fears might be happening are precisely the kinds of things the federal government, FERC, the FTC, and the U.S. Department of Justice's Antitrust Division a e concerned about and review. He offered that these agencies would be the appropriate venues to raise questions about what may be happening.

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MR. VAN FLEET referred to his next slide labeled, "Competition Law 360," and stated that at about the same time of the

Anchorage presentations, someone pointed out to him that the U.S. Commodity Futures Trading Commission (CFTC) had announced an investigation. He related that Conoco Phillips revealed it was subpoenaed. The CFCT is investigating possible fraud in the trading of crude oil futures. He acknowledged that doesn't mean the companies are guilty of any wrongdoing. However, he pointed out that the CFCT generally reviews particular trader transactions and investigates any company that it believes is fraudulently bidding up prices on contracts, which is deceptive trading.

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REPRESENTATIVE NEUMAN pointed out that some of the information provided, such as whether ANS crude oil is shipped to the Far East, seems to discredit some of the larger producers. He inquired as to whether Mr. Van Fleet could comment on the effect of lawsuits.

MR. VAN FLEET responded that his testimony is not meant to "bash producers." He related that he has worked with general counsel of major oil companies such as ExxonMobil Corporation and ConocoPhillips Alaska, Inc. He opined that the state does not want to rely on federal or state agencies to force [producers] into taking action on the pipeline. He surmised that the producers will be aware of the possibility of federal or state action if they do not have a rational economic explanation for their actions "except for keeping product off the market or delaying it as long as possible."

MR. VAN FLEET, in further response to Representative Neuman, answered that he is working for the attorney general.

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REPRESENTATIVE OLSON inquired as to whether he could name the two companies that are currently under appeal.

MR. VAN FLEET answered that the producers are not any of the ANS producers.

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CHAIR HUGGINS noted that that in the interest of time, he would bring up that question tomorrow for presenters to address.

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SENATOR BUNDE pointed out that [producers] booking reserves before the U.S. Securities Exchange Commission would be helpful for the producers' stock portfolios. He opined that booking the reserves would represent a de facto acknowledgment that the gas is marketable or profitable. He recalled that some attempt has been made to book reserves. He inquired whether producers could hint at reserves since actually booking the reserves would be illegal unless the producers could bring the gas to market.

MR. VAN FLEET responded that it not his area of expertise, but stated his understanding that the producers cannot book reserves in order to boost their balance sheets while simultaneously acknowledging that it is not economically feasible to get the reserves to market. He recalled Mr. Hosie's testimony such that the prospect of losing the reserves because they are not being developed would have a greater impact on the financial records of the producers. He spoke of an expectation for rationality, "not to lose both the Wall Street benefit as well as the physical gas."

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REPRESENTATIVE GRUENBERG inquired as to whether improvements are needed to update Alaska's statutes.

MR. VAN FLEET answered that he has reviewed the Alaska statutes. He stated that in recent years, Congress has increased penalties to a maximum of up to 10 years in prison and fines of up to $100 million for violation of federal anti-trust statutes. He said Alaska's statutes provide for a misdemeanor and small fines for violation of anti-trust statutes. He opined that while the civil consequences and civil recovery for violation of Alaska's anti-trust statutes could be huge, the criminal penalties are weak.

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REPRESENTATIVE GRUENBERG related his understanding that a new series of federal laws have been adopted. He asked, "Does that preempt the field; should the state be looking at filling any gaps there?"

MR. VAN FLEET answered that the state could always look at "filling in the gaps." He stated that approximately 15 years ago, the U.S. Supreme Court held that the nationwide purview of federal anti-trust statutes does not preempt the states from enforcing their own laws. He said this occurred in the context of a merger that the federal anti-trust authorities had approved and were not going to challenge. However, he offered his belief that this did not prevent California from raising its own objections under its Cartwright Act, even though that would have had immense national implications. He related that the states are free to act under their own anti-trust laws, regardless of whether the feds act under theirs. Mr. Van Fleet noted that since the Reagan Administration, when there is a matter of national importance that is also particularly important to an individual state or group of states, very often the federal anti-trust authorities will work with the states' attorneys general, either one or several, through the National

Associations of Attorneys General, which has a specific anti-trust committee. So, he said, the cooperation of federal and state governments is something that is well entrenched and a tradition in anti-trust enforcement.

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REPRESENTATIVE KERTTULA inquired as to whether Mr. Van Fleet's quote that the FTC believes that BP is occasionally exporting ANS to increase spot prices came from the FTC decision.

MR. VAN FLEET answered that he was not sure if that information was contained in the decision on the merger, whether that information is in the consent order in which BP agreed to divest the ANS holdings of ARCO. He recalled that the information is described in the live request for comments on their advanced notice of proposed rule making. He offered that the FTC pointed out that that was the type of market manipulation that it saw during its investigation of the merger, and is something it wants to consider as "being within their enforcement powers under the new market manipulation statute." In response to Representative Kerttula, he noted that notices of advance proposed regulations can be found on the FTC web site.

4:40:57 PM

REPRESENTATIVE FAIRCLOUGH recalled that Mr. Hosie stated that Alaska could take its royalty in-kind in oil and then sell that oil or gas onto the market for any price it so desires. She inquired as to whether that's true since she further recalled that the state previously researched that matter during the closing of the Agrium plant and found that the state did not have that ability.

MR. VAN FLEET answered that he is not prepared to answer that question without first conducting significant research. He said:

> Alaska, like other landowners in other stares, has the option - and, as I recall, under the Stranded Gas Act was going to have the requirement - to take gas in-kind. Now, if the state has the option or the requirement to take gas in-kind and it can't sell it, well, that's not a very good deal and clearly there must be some opportunity to dispose of that. But as I say, that is not something I've researched and [I] would be misleading this body if I were to pretend expertise on that ....

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REPRESENTATIVE FAIRCLOUGH recalled that it was on record from Mr. Hosie that Alaska could sell the commodity for any price it wants. She offered her belief that in Alaska it would have to be at a competitive price to others in the market.

CHAIR HUGGINS interjected that he will follow up with the administration and Mr. Hosie.

MR. VAN FLEET elaborated that the anti-trust laws display basic faith in the market. He said that the anti-trust officials don't want to be in the business of setting prices. Thus, it is extremely rare that anti-trust laws will examine the prices at which a particular company is selling its goods, its products, and its services, he stated. He pointed out that the anti trust officials become involved only when a company has monopoly power or a dangerous probability of gaining monopoly power and sells its product below cost. He offered that when it is clear that the company's motive is to put someone out of business at that below-cost price, it is then that the anti-trust officials become involved in pricing.

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REPRESENTATIVE FAIRCLOUGH expressed her concern that if the state could offer its gas at below market value, that action might create anti-trust problems for the state. She stated on a separate matter that one of her constituents informed her that the Texas Railroad Commission based an allocation for access to a pipeline of proven reserves. She related her understanding that access to pipelines is based on contract versus common carriers. She inquired as to whether Mr. Van Fleet could speak to the issue of access to pipelines based on proven reserves.

MR. VAN FLEET responded that is not fundamentally an oil and gas lawyer and is not familiar with those commission regulations He added, "It would be strictly intrastate pipelines, and I don't think we have many of those anymore." He said that regulation would be up to FERC.

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CHAIR HUGGINS inquired as to whether there were other questions and there were none.

MR. VAN FLEET concluded his presentation by offering that he is not here "to bash oil companies and gas producers." He noted that he has worked for them, has advised them, and has many personal friends in the industry. He said:

> These are serious matters that come into play beyond the simple private relationship between the state as landowner and the producers as the contracting producer and are something that make this of interest beyond Juneau, beyond Alaska, and of interest to us in the Lower 48, as well, and I do thank you for your time and your attention.

4:46:56 PM

CHAIR HUGGINS announced that this concludes the presentations for the day. He noted that the meeting would resume at 10:00 a.m. tomorrow and that the committee would take up follow-up questions for Mr. Hosie, followed by regulatory and commercial issues, and LNG economics.

**DRAFT**

**ADJOURNMENT**

There being no further business before the committee, the Joint meeting House Rules Standing Committee and the Senate Special Committee on Energy meeting was adjourned at 4:47 p.m.

**DRAFT**

7

| Refineries Location | Owned by | Production Level |
|---|---|---|
| Kenai Refinery | TESoro | 72000 bbl/d |
| Valdez Refinery | Petro Star | 50 000 bbl /d |
| North Pole Refinery | PetroStar | 17000 bbl /day |
| Kuparuk Refinery | ConocoPhillips | 14400 bbl /d |
| North Pole Refinery | FlinT Hills Resources | 210 000 bbl /d |
| Prudhoe Bay Refinery | BP | 12,500 bbl/d |

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Idaho - no refineries

Montana - 4 Refineries

| | | |
|---|---|---|
| Billings Refinery | Conoco Phillips | 58 000 bbl/d |
| Billings Refinery | Exxon Mobil | 60 000 bbl /d |
| Great Falls Refinery | Holly Corporation via Monta Refining | 8200 bbl /d |
| Laurel Refinery | Cenex | 55000 bbl /d |

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North Dakota

| | | |
|---|---|---|
| Mandan Refinery | TESoro | 60,000 bbl/d |

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South Dakota - no refineries

Washington - 5 Refineries

~~Tesoro~~ A - see back

| | | |
|---|---|---|
| Tesoro Anacortes Refinery | Tesoro | 108000 bbl/d. |
| Shell Anacortes Refinery | Shell | 145000 bbl/d |
| Cherry Point Refinery (Blaine) | BP | 225000 bbl/d |
| Conoco Phillips Ferndal Refinery | Conoco Phillips | 105000 bbl/d |
| Tacoma Refinery | US Oil + Refining | 35000 bbl d |

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Wyoming

| | | |
|---|---|---|
| Cheyenne Refining | Frontier Oil | 52000 bbl/d |
| Evanston Refinery | Silver Eagle Refining | 3000 bbl/d |
| Evansville Refinery | Little America Refining | 24500 bbl/d |
| Newcastle Refinery | Wyoming Refinery | 12500 bbl/d |
| Sinclair Refinery | Sinclair Oil | 10,500 bbl/d |

House Judiciary Committee meeting
September 10, 2008
Fairbanks Legislative Information Office

Representative Ramras, House Judiciary Chair convened the hearing at 9:16 a.m. by welcoming those in attendance.

Members of House Judiciary Committee:
Rep Gruenberg, Rep Holmes, Rep Dahlstrom (on line), Rep Coghill

Other Legislators:
Rep Hawker, Rep Guttenberg, Rep Kawasaki, Rep Roses

Ed Sniffen, Senior Assistant Attorney General

Rick Solie, Conoco-Phillips;
Jeff Cook, Flint Hills; Mark Gregory, Flint Hills; Alan Hallock, Flint Hills; Mark Palazzo, Flint Hills;
Kip Knudson, Tesoro;
Doug Chapados, Petro Star

Representative Ramras asked the first speaker to come forward and address the committee.

**Lois Hein, Co-owner Riverview Quick Stop**
1316 Badger Road, North Pole, AK 99705 (Business address)

Lois stated that a few weeks ago they called for gas and could not get it, because Flint Hills was slowing production. At that point we had to close our pumps. I called around to find out what was happening. If they could not get gasoline it would have to be shipped up from Anchorage. For a small quick stop not having gasoline, especially in bad times, makes it even worse.
People that come into the store have been signing a petition against high fuel pric in Fairbanks, even though prices are going down all around the other states. She saw a 20 cent decrease a few weeks ago and then another 8 cents when the gas tax was taken off. She is glad the investigation is being conducted; people feel they have no recourse. We see a lot of people that are going to have to move. The petition has approximately 146 signatures. She was going to forward them to Sarah Palin, hoping she is not too busy. She would like to give them to Rep Ramrus.

Rep Ramrus said that he would take the petition and have copies sent to appropriate state agencies.

Lois - wants to be able to tell people something is happening and that they have a voice.

Rep Holmes - where does your gas comes from?

Lois - it is delivered by Alaska Petroleum from the Flint Hills refinery.

Rep Holmes - has this been a problem in the past?

Lois - never.

Rep Gruenberg - has been looking at some of the other states that are considering anti-gouging legislation, but most seem to trigger their protections on a declaration of a state of emergency. At least one state has amended their legislation to broaden the definition of "state of emergency" to include economic emergency. If a situation is bad economically, the governor can declare a state of emergency. Do you think it would be appropriate for us to consider that there could be an economic emergency to trigger protection?

Lois - there are people who do not pay their bills and with all the rising prices in the grocery store, it is costing everyone more. Vendors are raising their prices 3 or 4 times a year. People can't afford to live here.

Rep Gruenberg – do you know how much the prices have been raised?

Lois - we raise them every week, but we are still having a difficult time buying product for the store because of increased prices.

Rep Gruenberg – how much has it increased in the last week.

Lois – about $1.00 – the price is now $4.38

Rep Ramras – can you comfortably tell us what your margin is – pennies per gallon; what is the fee if you pay by credit card, and what you estimate your volume is in relation to big box stores?

Lois – we put 20 cents a gallon on gas, credit card prices are 5 cents more. That is the same with diesel. We used to sell about 700 gallons a day and now its about 300 gallons a day. I think that is because people are driving less. We are 20 cents higher then they are in town at places like Fred Meyer and Safeway.

Rep Guttenberg – when you call your distributer and they tell you it is not available, do you get a reason?

Lois – I have never gotten that response ever before. It has always been available. That morning I was told to call back later. I called back later and they explained there was a problem at the refinery and it was a little later we discovered that production had stopped.

Rep Gruenberg – for the record and information – when I mentioned that the definition of disaster was expanded it is in House Bill 653 from North Carolina and is in the packet.

Rep Ramras asked Lois to leave signatures with Jane and copies will be sent to appropriate state agencies. He thanked her for her testimony.

Rep Ramras asked Ed Sniffen to provide a legal and historical perspective of this issue and give the committee members an update on the Attorney General's investigation.

Ed Sniffen, Senior Assistant Attorney General, - he was not here when the prior gas investigation was done from mid 90's to 2000 – but that the focus was whether or not there was anything illegal going on; there was not. The AG is once again looking at those issues. When I heard the testifier talk earlier about higher prices, I am sympathetic to those concerns, but have to ask myself – what do we want to do about it, what can we do about it. We cannot control the prices that businesses set, whether its a can of tuna, or a car dealer, we rely on the market to set those prices. You sell it for whatever the consumer is willing to buy it for. The problem is that the demand for gas does not change much. When there is a demand increase it might cause producers to look at their prices and be able to make a higher profit. When it comes to gas – it relatively does not change. We have to use it - we have to buy it. There is not a broad transportation system, so we have to buy gas and it is one of the realities that we live with. The demand does not go down. Looking at how can we lower the prices, lower the demand. Also, look at whether there is anything illegal going on with the pricing. We do not have a price gouging statute in Alaska, and in states that do have those statutes, they are all triggered by a state of emergency. They stop businesses from jacking up prices until the emergency is gone in order to not take advantage of fear. If we had that statute, it probably would not apply. There are problems with legislating market prices. Maybe it could include economic strife.
Then there are anti-trust laws. It conjures up images of things that are hard to get your mind around. We want the operation of the market to stay competitive, and fair competition usually drives prices down. Our laws exclude price fixing – so looking from an anti trust perspective is - are these people colluding in such a way to keep the prices high, or are they doing something else that is keeping the prices high. When it comes to pricing goods and services, the legal remedies are narrow and few. We look to see if it is running competitive and without collusion, then it is a competitive market and prices are what they are. There were some components of the production that had to be fixed before more production could continue and so the lack of product was due to that rather than anything illegal and Flint Hills will address that.

Rep Ramras – as the price of oil went to \$145-\$147 a barrel – if price had followed that, we might have seen gas run as high as \$6 per gallon, and yet as the price per barrel comes down, people expect the price at the pump to come down. He gave an example of where it can take months to bring the price at the pump down when the price per barrel comes down. He talked about the State of Alaska selling royalty oil at super premium, so if there is a culprit it might be the state. He talked about pricing for retail customers and the disconnect that may exist between the price of oil and how the relationship is restored.

Ed Sniffen - had this discussion with the economist the AG's office has retained. We discussed the lag, where the price has not gone up enough, the refiners are in a deficit, and then the prices come down slower. Historical price wave in Anchorage, the historical trend has always lagged a bit behind, as it does in Seattle. This lag is particularly long, and when prices started to fall and prices did not go down and after a month they still did not fall, the question was why? We are speculating and in the investigation we are trying to find out why. Seems like the run-up was so dramatic and so fast, that it caught everyone off guard. We see prices coming down a little bit, but we don't really know how much of the market is being driven by the tax break but we need to see what happens

Rep Ramras made reference to a chart that shows pricing in Alaska compared to other states in the U.S. There are comparisons between the small states, and those that are also producers. North Dakota and Montana are small states with similar characteristics as Alaska.

Rep Gruenberg – anti trust and anti gouging. We are a common law state and so the state can use common law. Has the common law developed anything?

Ed Sniffen - if prices got too high, there is a rule of conduct that the price is so high that it cannot be allowed. He has never seen it applied to gasoline.

Rep Gruenberg - ever seen it in any jurisdiction for any product?

Ed Sniffen – not aware of any. But when we look at different areas, if you have something like that going on there is usually fraud going on and so the fact of the high price alone has them usually focus on some type of illegal action.

Rep Gruenberg – any common law in consumer protection?

Ed Sniffen - almost all consumer protection is code based.

Rep Hawker – talk that the state does not set market prices and we hesitate to step in – but we do have a large precedent of regulated prices – essential life services, a whole body of regulated prices. There is something that we could do if we did a regulatory process, the Regulatory Commission of Alaska. If we did embark on a regulatory process, we could grab the refiners by the horns and regulate them – but if we were really regulating that process and in fact the actual prices were not being passed on, would it be likely that the regulators would require the seller to incur losses, or do you have the right to recoup your capital costs; so in fact if we were regulating prices we actually might have seen higher prices?

Ed Sniffen – that is absolutely correct. The state of Hawaii did initiate regulation of prices and it failed quickly. Prices went up very quickly and never came down - it was a disaster. It is a very difficult thing to do. Under our current regulatory theme, if the utilities want to change the price, they have to have a study done and then the price is set. If we regulated refineries, the rate would be set and then if there is a change there would have to be overview again. It would be difficult, the markets move much more quickly with oil.

Rep Hawker – recognition regarding the price that the state charges for royalty oil, but is there not a settled court case, a ruling that has the state sell its oil at market rates.

Ed Sniffen – not sure what the provision is, but the constitution says that the state must sell at market rates for the benefit of all the citizens. However, it is a double-edged sword, because it is what causes the prices to be higher.

Rep Hawker – in referring to the chart are the prices reflected less states sales taxes or is that just the excise tax?

Jane – the numbers do not represent the excise tax.

Rep Hawker – wants to make sure that apples are being compared to apples, because the sales tax is Alaska's excise tax.

Rep Ramras – there is a relationship between Alyeska and the producers and refiners, and he asked Mr. Sniffen to talk about the mechanism that gets oil from the north slop to the consumer, which entities that goes through. Which entities have common ownership and vertical integration from oil production to consumer.

Ed Sniffen – from the refinery to consumer I can discuss, but upstream from the refinery I cannot answer. When refineries makes the gasoline product that goes to the stations – they may be leased, or perhaps a private company or they may be branded stations and to be branded you have requirements and then there are some independent stations (Polar Fuel) and they call as they need gasoline. Then some go to the rack and take the fuel to their own station. But there is usually a relationship with the refinery. The agreement usually includes a rack price and the different relationships come into play to get the product to the consumer. Pricing decisions for the most part are left to the independent retail stations. Those decisions are driven by the refinery price at the rack.

Rep Ramras – define some of the words being used and how refinery prices at the rack are set and possibly tracked.

Ed Sniffen – Rack – outlet at the refinery where fuel is sold. Opis tracks rack rates from all over the world. Jobbers are entities that transport the fuel from the rack to different stations. Usually jobbers are related to the station owners and the refinery in some way, there may be some common ownership or common control. Independent distributors will deliver to anyone, they charge so much per gallon.

Rep Ramras – relationship is from refinery to jobber or any type of distributor to the retail consumer station.

Rep Coghill – jobber possibly has a brand loyalty and gets some kind of benefit for that.

Rep Roses – to go back to where Rep Gruenberg asked about anti trust issues. Are you familiar with the anti trust case that came about in the 70s? It was the only other time that an anti trust case was filed and it was filed against 18 independent owners in Anchorage.

Ed Sniffen – there was that one and one in the 90's where there was collusion going on.

Rep Roses – to put it on the record, when the state did this – it was when there was the gas shortage. It was against 18 owners and included about 30 stations. There were shortages all over the country. Cars lined up for blocks and during that time you could get a call 5 times a day that prices would change. And if you got gas when it was lower, you could make money, or you could lose it. There will be more discussion when I give my testimony later this afternoon. I was one of those 18 owners.

Rep Ramras stated that the committee will now hear from representatives from the oil industry.

**Jeff Cook, Director of External Affairs, Flint Hills Resources**
1100 H&H Lane North Pole, Alaska 99705

Mr. Cook read a prepared statement into the record. 60 years of experience. They have owned the North Pole Refinery since 2004, and have refineries in other states. Began after the Trans Alaska Pipeline was completed. Configuration of Flint Hills is pretty much unchanged. It is a topping plant, can't turn all crude into refined product . 180,000 – 220,000 barrels of crude taken in per day. After crude is distilled and turned into a few basic products the rest is returned to TAPS. Only about 50,000 barrels a day of saleable products – majority of which is jet fuel. A quantity is kept to heat the crude in the refining process.
Increased environmental emissions regulations caused many topping plants to close. Increasingly stringent federal requirements on the type of fuels produced forced others to close. North Pole Refinery was able to keep pace with new environmental regulations, but changes in type of fuels required has impacted the amount of gasoline that can be produced . While the Refinery still produces some gasoline and off-road diesel, we now buy gasoline and diesel fuel from other sources in order to meet the full needs of our customers. We are not in the crude production and do not own retail stations. All products are sold on the wholesale market. We provide less than 1/5$^{th}$ of gas in Alaska and only 1/3rd of heating fuel in the Fairbanks area.

Rep Ramras - there is ongoing tension with the state that Flint Hills will not open its books for state review. Flint Hills is still using oil to refine its gasoline even though natural gas is cheaper. Can you talk about that distinction and costs that are unique to Flint Hills Refinery?

Jeff Cook – we refine the crude oil into a product into gas to run our refinery. So high prices impact us. Most plants run on natural gas. Most have to run on a product we refine. We are at a disadvantage. Energy equivalent is 6 to 1.

Rep Ramras – if we had natural gas in Fairbanks can you refine for less and then pass savings on to consumer.

Jeff Cook – assuming that natural gas comes in at a price like Anchorage it would reduce our costs and though there are variables – a price like what is in Anchorage would make a significant difference to us.

Rep Ramras – can you give us some numbers on what it would mean if we could change oil to gas for you to use for your refinery production. It would be a material component for us to look at for our consumers to save on. Flint Hills would use about 5 bcf in order to make the swap. Am I fairly on?

Jeff Cook – you are within the approximation. We are working with the state on providing info they want for their investigation while maintaining our confidentiality. Would be pleased to work out confidentiality so our numbers can be shared with this committee.

Rep Hawker – if you can lower costs you can lower price to producer. But what would be the capital requirement cost that would have to be addressed and how significant?

Jeff Cook – does not have number.

Rep Gruenberg – do you know zone pricing?

Jeff Cook – not familiar with it.

Rep Gruenberg – Legislation in NCSL 2641 – prices set pursuant to the zone. A wholesale price set based on geographic regions shall be deemed excessive.
Done where wholesale or retain sets prices decided on regions.

Jeff Cook – does not know anything about that.

Rep Kawasaki – how do you set your heating fuel rack prices?

Jeff Cook – market sets the price and we remain competitive. Everyone wants to know if there is some magical formula, but there isn't - it is the market.

Rep Roses – zones were created for wholesalers – you could be situated in a geographical situation where you pull fuel from different states, and that would not set up a situation ··re they could price lower because they were purchasing the gas at a lower price. ·ney wanted to level the playing field, and that is how it was set up years ago. It is not available here in Alaska.

**Doug Chapados , President, Petro Star Inc.**
3900 C Street Anchorage Alaska 99503

Doug Chapados read a prepared statement into the record. Incorporated in 1984 and in terms of companywide refining capacity, is smallest in-state refiner, only one owned and controlled by Alaskans. Operates 2 refineries. North Pole crude oil processing capacity of 20,000 barrels per day; and Valdez with a crude oil processing capacity of 48,000 barrels per day. Simple plant – military and commercial jet fuel and home heating oil and diesel fuels. It also markets fuel to end users. It refines crude oil, but does not produce gasoline. Gasoline we sell at the eleven convenience stores is purchased from third parties. Challenges facing refineries are increasing environmental regulations. Modifying one of the refineries to produce ultra-low sulfur diesel is estimated to cost more than it did to build the refinery in the first place. Looking at whether or not it can be justified and if not what next. Record high prices are good, but also create hardships for Alaska families. Passed along fuel tax rebate to its customers. We try to stay competitive, but we do not control prices that we are charged.

Rep Ramras – asked again if we had natural gas would it reduce cost of production?

Doug Chapados – natural gas would be cheaper. There is some limit on how much we could use natural gas because of components in some production of gas. But it would blend into our production. Low sulfur is a federally imposed regulation.

Rep Ramras – is gasoline one of the few value added products that the State produces.

Doug Chapados – disagrees.

Rep Hawker – increasing challenges to produce home heating fuel. What is the challenge.

Doug Chapados – basically all the fuel quality standards are at the federal level. We are a little different as we are defined as a small refiner. We get to delay implementation of meeting the low sulfur standards for 4 years. But that benefit has then limited the amount of high sulfur fuels we can produce. The volume caps were based on years we sold less volume and now we are in a position where our North Pole refinery can produce and sell less than it used to. We have to limit the sale of high sulfur fuels. So we have excess production on the north slope. We truck product to Anchorage and then to meet interior demand truck to North Pole. Each step adds more cost. Trucking fuel that could be sold locally but because of cap we are selling it in Anchorage. Caps cause an increase in costs. This is all part of the low sulfur fuel provisions from EPA. State of Alaska had some input how they would be applied and the state did a good job in making a distinction between rural and local areas. A good help to the citizens of Alaska.

Rep Hawker – the low sulfur business and clean air – is worth tradeoff. Make a comment on refineries on west coast and our area – is it really an issue in Alaska. Or is it just because we are getting one size needs to fit all.

Doug Chapados – it does apply because diesel vehicles cannot burn high sulfur gasoline. Like the unleaded and leaded gasoline with the converters on vehicles. As the automobiles change, we need to change our fuel sulfur rates.

Rep Hawker – remember days of oil embargo and everyone shifted to diesel because it was cheaper and now gas is cheaper – why?

Doug Chapados – prior to implementation of on road and off road low sulfur diesel standards, all refineries in the state could produce highway diesel but now only Tesoro can produce it. You went from 6 to 1 refinery that could product it. But it did not come cheap to Tesoro, but at the same token Petro Star has a limited ability to produce low sulfur and we really only take care of our own needs.

Rep Ramras - you have 11 retain establishments. Can you tell us your margin on a per gallon basis. Lois is 20 cent gross profit per gallon.

Doug Chapados – in response to what the price margin was on his retail establishments, he said they fluctuate and would prefer not to comment. What we are trying to do is be competitive and yet break even with gasoline. There are times when we break even and sometimes lose. Make more money on inside sales than gasoline.

Rep Kawasaki – how do you design your rack rate.

Doug Chapados – just like Flint Hills – it is market driven and needs to be competitive.

Rep Kawasaki – can you prove that you took the 8 cent tax break off your price at the pump.

Doug Chapados – can get the number to the committee.

Rep Ramras – there is a sense of extraordinary profitability during pricing spike and can you talk about whether or not there was a great premium enjoyed by Petro Star on your profitability or does your company enjoy more equilibrium of profit when there is greater stability in the commodity.

Doug Chapados – with respect to increased profitability – sales of jet fuel are to large customers and tied to Opis info and is used to enter into an agreement through bid or negotiation and the price is tied to that index. Sometimes the price is up but is outside of our control. We have seen the up and down of it. We don't have much influence on that price. As for gas, we don't produce it so can't comment. We don't think we passed on all the increase of costs when gas went up so high.

Rep Ramras – well it sounds like you did not get record profits, but people seem to feel that there have been enormous profits made by the fuel companies during these times of higher oil prices. We need to see if a new law or constitutional amendment is needed in order to deal with this. Initial charge from Speaker Harris, is why when price of oil comes down price at retail establishment does not come down.

Doug Chapados – as Mr. Sniffen indicated is that price run up in crude oil was not carried over.

Rep Coghill – you deal mostly with contract jet fuel and heating oil – what is your volume? How would the refinery do if it could not contract with the military? I am trying to get an idea of price balance of military contract or heating fuel. I understand you have a sizeable market share of heating fuel in Fairbanks.

Doug Chapados – noting before – if we were to lose the Eielson volume we are prevented from selling that product as heating oil in the Interior because of the caps. Jet fuel is excluded from that cap. Only outlet would be to truck it to Anchorage to sell.

Rep Ramras – one of the things we are uncovering is that all the refineries are fragile not the vast profits that some assume.

Rep Coghill – will be asking – the volume of gas produced and consumed and necessary for Alaska.

Rep Hawker – it helps to see the fragile nature of this industry. The importance of the military contract so high sulfur jet fuel can be sold. Does the coming commitment from DOD to convert to synthetic fuels become a problem within the state.

Doug Chapados – it is a threat. They are watching it very closely.

Rep Hawker – we have to build new refinery capacity and it is going to happen. You lose that portfolio it will be worse and layered on the retail consumers.

Rep Ramras – you are referring to Mayor Whittakers coal to liquids for Eielson as a response to DOD's decision to change to synthetic fuels.

Rep Ramras – what would happen if Alaska said oil would not be sold for more than $100/barrel. How would that change the cost structure. Contemplate an answer to that question.

**Kip Knudson, External Affairs, Tesoro Alaska Company**
471 W. 36th Avenue Suite 100, Anchorage, Alaska 99503

Kip Knudson – (power point presentation) Tesoro has a refinery in Nikiski. Need to look at refinery as most valuable more value added industry in Alaska. Tesoro is an independent refiner and marketer. Publicly traded. Kenai Refinery has distribution and retail. 72,000 bpd capacity. Medium complexity refinery. Do some conversion at the plant. Take 100% volume and make 125% volume. Heavy Vacuum Gas Oil, Fuel Oil/Bunker and Road Asphalt – have no market in Alaska and those are exported. Crude acquired from North Slope 50%, buying it from Anadarko. Integrated ducers have their own refineries. Cook Inlet 25% purchased. 225,000 per day currently 16,000 per day. It is a mature region. 25% foreign imports. Charter vessels – time charters, about 500,000 per tanker. Showed a slide of where fuel comes in and where it goes out to. Refinery, to racks, Nikiski terminal for local distribution – as in Anchorage and Anchorage airport. Sells to anyone that will purchase from them.

From Kenai refinery to Anchorage port. 10" pipe, clean products only. Two terminals at port of Anchorage. Company owns 31 convenience stores of which 29 sell fuel. They have over 58 branded dealers. 2GO and Tesoro. What makes up the gas prices – cost of crude oil, cost to refine, cost to distribute, cost of marketing, taxes and competition. The cost of crude oil is the lions share of cost. Cost of crude responds to different markets – crude responds to global factors, supply and demand, value of dollar, geopolitical concerns and flow of investment funds. Refining/distribution costs – global regional factors – electricity/natural gas costs, environmental regulations equipment costs and availability of qualified labor. Additional capital investments because of external regulations and trying to stay in business by changing refinery. Market sets the price. Set by competition and local market characteristics. Not cost plus. Alaska and other western markets. Alaska is really a very small demand. Jet is king in Alaska and that is what the refineries were built for, gasoline and diesel is a byproduct. Also there is such a seasonality of the market and quite different than west coast. Emphasize – retail prices are set by individual retail owners. Retail prices respond to differing local conditions. Alaska market is very small and very seasonal. Tesoro only prices 29 stations of 566 in state. Tesoro will respond to AG investigation with information that can't be shared in open forum.

Rep Roses – interesting feature is taxes, speak to that and how it changed after ACES passed.

Kip Knudson – no change. Oil is globally set. No change in prices.

Rep Hawker – you have a change. When they buy crude they can put some back. When you buy crude you can't put it back.

Kip Knudson – roughly 1/3$^{rd}$ of our output is sent outside for processing or something. We buy it we own it. Bottom third generally sells at cost or below price. The economic prospects are shown in the stock market price of Tesoro.

Rep Hawker – did not realize 25% was from foreign source.

Kip Knudson – foreign source will increase as Cook Inlet continues to decline in production.

Rep Hawker – if possible would you use more North Slope than foreign.

Kip Knudson – would love to have more product from North Slope. Tesoro used to be a big royalty oil consumer, but that has diminished and not sure that the crude buyers were happy with the way the royalty oil was sold.

It is relevant. How do we keep the cost of product lower in Alaska, but reliable. Appreciates the integrated TAPS owners, but the State is carrying a lot of royalty oil too. Have you ever approached the State.

Kip Knudson – used to be a big royalty oil purchaser. Not as much now, there is less and I am not sure the buyers were pleased with the royalty oil process. After you bought the barrel years later you might get an adjustment. We are not purchasing now, maybe in the future.

Rep Coghill – the ability for you to get Alaska crude could not be from ships, because of regulation.

Kip Knudson – no it is part of the Jones act. We have foreign flag ships. Cook Inlet is limited on how much can be on tankers due to spill response. Can't enter inlet with more than 500,000 barrels.

Rep Coghill – 25% of whatever you import you don't have a refined or partly refined product.

Kip Knudson – it is raw – but has to be similar to Cook Inlet crude.

Rep Coghill – wants to look at what you have to do to sell the bottom three and if there is a similarity cost. Look at the quality bank issue, and what the balance of the cost is.

Rep Ramras – you do refine with natural gas, but you have bottom third to equal out.

Kip – spaces in the market, each refinery has issues, we have the bottom third to deal with.

Kawasaki – how do you decide what the rack price for distributors is?

Kip Knudson – honestly don't know, but if I did know, can't say because of confidentiality.

Rep Kawasaki – Slide 15 – large spot market pricing in LA, SF, & Seattle. What factor does that have in your decision making. Is it a high factor. Do you look at prices in Seattle when you decide what the price will be in Alaska.

Kip Knudson – those spot markets are guidelines, but are unbelievable fluid compared to Alaska. They are taking product from hundreds of refineries and sometimes they do not apply, but are taken into consideration.

Rep Hawker – what proportion of highway motor fuel sold in Alaska both gas and diesel does Tesoro provide? Are you a large player, and who are your competitors?

Kip Knudson – not known. Because of what is being delivered to a barge and it could end up as jet fuel, motor, or diesel fuel. We are a large player. Because we don't know when our competitor brings in product, until maybe after we see price movements. We don't get a report that said X competitor is bringing in product. From state reports product comes in from Korea or Japan. On ultra low sulfur diesel we are the only plant that can produce it. So that raises our share of market.

Rep Kawasaki – the 8 cent gas tax can you show that your price was reduced?

Kip Knudson – yes we changed the price to reflect the tax reduction from the State.

Rep Ramras asked Doug and Jeff up to the table to discuss why the prices do not seem to come down at the pump even though the price per barrel is lower. Refer to the chart that shows the difference in prices at the pump and why the disparity in pricing?

Kip Knudson – Alaska average – retail gas price from Bethel and averaging that with Fairbanks (this reflects urban markets in rail belt area). Market forces have produced these prices. 3/2007 – Anchorage has lowest gas prices.

Jane explained that the A ska prices are from markets along the rail belt.

Rep Hawker – three of you represent the major market players in the Alaska market at the refiners level. Crude oil topped out, at about $147 per barrel. We are trading about $101 a 46% reduction in last three months. Why have people in Alaska not seen a 46% production in their price?

Jeff Cook – Flint Hills – less than 1/5th of gas market. But if you were to look at crude and retail price – it would have been $6 per gallon. For the majority of the last 12 months we have lost money.

Rep Hawker – had you truly passed on all the price increases you would have been attempting to sell at least in the State of Alaska at $6 per gallon.

Jeff Cook – look at the traditional relationship, it would have been a lot higher. We can't continue to lose money and still pay high prices to run the refinery and retail prices have not followed crude prices.

Rep Hawker – the direct answer is truly the retail prices have not followed the crude prices. You can't draw a linear conclusion – crude prices dropped 46% - you can't expect that retail gas prices should have dropped the same. It is not apples to apples.

Rep Holmes – what is different everywhere else in the country? The prices did not go up to $6 per gallon, so the up was similar but other parts of the country are coming down. Why so different here?

Kip Knudson – AG inquiry in State of Washington, they went county by county to look at variability in WA every county had a different story. Different story for each area. Within each county it was sometimes different. The data of market share cannot be arrived at – but the economist can through a confidential basis and come up with some answers for you.

Rep Ramras – what percentage of the highway motor fuels comes from Tesoro. Who else is producing motor fuels in Alaska?

Kip Knudson – we know who is producing it, but we don't know who is importing gasoline.

Rep Ramras – what if there was a constitutional amendment that put a cap on how much gasoline was sold to from the state's royalty share to the refiners. Trying to find ways that the consumer could derive the benefit, rather than the resource rebate. Would that help the consumer derive a direct benefit?

Kip Knudson – virtually impossible to predict. That is why economists go to school for years.

Rep Coghill – market dynamic of that and ability to supply that to the refiners and the constitutional issue and how do we make those work together is the question. The ability to produce enough royalty oil to meet the demand of our refiners. Get DNR to help us.

Rep Ramras – it was a surprise that Tesoro imports foreign oil. And when is the state not going to be able to meet its royalty oil obligation. When do you think that would happen?

Jeff Cook – we are allowed 77,000 barrels per day, but not more than 95% from any given field. With those restrictions if we were demanding the max it would be hard for the state to provide it.

Doug Chapados – we get our crude oil supply from a major producer.

Rep Kawasaki – if they are not taking all that they are allotted, if that is true, can you explain that regarding your capacity.

Jeff Cook – we take as much royalty oil as we have product demand to sell. But because of the restrictions – we are at the maximum capacity we can do for gasoline.

Kip Knudson – the production rate we have is to meet market demand and we don't want to do more. Production capacity changes daily. Every day can be different.

Doug Chapados – Valdez refinery runs near capacity, doing some expansion work, to process more. North Pole refinery because of volume cap limitations does not run at capacity at all times. We have to anticipate what volume will be on heating oil and low sulfur and find out what the volume will be and sometimes we have to cut back or truck to Anchorage and that cuts into crude oil.

Rep Roses – at any point in time do you run 100% of capacity.

Kip Knudson – does not think he has every maxed out. Don't want idle equipment, but can't say what the capacity might be. Does not know the actual output rates. Info is being given to AG.

Rep Hawker – operates in multiple state sites and can you talk about the economy of scale and how the unit costs compare to the mega refineries. We don't have Exxon sitting here and it is relevant – are some of our costs driven by small production. Are unit costs pretty similar across the different states. Tesoro has a single refinery in North Dakota and the chart is going to prove and when they get net cost less taxes, and it is going to be cost to the consumer (sales price) and one year ago ND $2.90/gallon Alaska $2.90 cents – right on the mark. Now ND $3.50 Alaska $4.50 and so again, I am wondering how you explain the difference.

Kip Knudson – can't answer the question today. But the cautionary note is that there are other pipes and trucks that move around North Dakota. Will try and get the data for you.

Rep Ramras – a follow up meeting in October will be important and see how these prices fluctuate and see how the market should correct itself. We will get in the other information that will be necessary to see how these prices are changing. Home heating oil has come down $1.00 but not gasoline. What is difference in these products, diesel vs gasoline?

Kip Knudson – heating oil is a high sulfur product, highway fuel is a low sulfur product.

Rep Ramras - market force has lowered heating oil, but not gasoline.

Rep Coghill – he heard that the cost of upgrading to the low sulfur takes time to recoup the cost. Is that one of the reasons for the lag in prices at the pump coming down?

Kip Knudson – can't answer the question. AG is looking at those types of things. Just because we make a capital investment does not mean we raise the price of fuel to capture that cost. But that is not a guarantee.

Rep Hawker – recently made a 60 million dollar investment to stay in gasoline business (specifically for diesel). Then you are operating in a multi-state environment and the prices are less competitive than in the other states you operate in. Does not want the prices high here to recover the costs that are more difficult because the market is more competitive.

Kip Knudson – can't answer the question. Mr. Sniffen will be looking at that data and come to a conclusion.

Rep Gruenberg – I don't hear a simple or concise answer to the problem, and they are competitors, and some other states have specifically authorized their AG to investigate these areas and there is confidentiality, ultimately the legislature would be well advised to get a handle on what the causes are whether they are external or internal. And when prices went down – why was there no investigation done and what did happen?

Kip Knudson –no idea why prices went down. Internet sites to track fuel pricing. They go up or down and eventually intersect. Pricing to a great extent is based on local conditions. How many retail sites and how many trucks and how many refineries are all important to what the price is.

Rep Gruenberg – is it because we don't know or can't know.

Kip Knudson – how good is the state at setting prices. Some prices can be estimated and projected, but ultimately how accurate are the predictions.

Rep Gruenberg – can we know more than we do now, even if it is not precisely. Because it would benefit the individual and government. How can we solve the problem?

Kip Knudson – consumers may not like the price but the market is performing as it should. Markets operate in a way they are expected to operate.

Rep Roses – just a comment. I appreciate the testimony of these three folks and understand how difficult it is for them to answer questions. He gave information about a situation he was involved in in Anchorage when he was a station owner. Prices were so volatile in Anchorage the owners decided to come together to talk once a week. Group called Gasoline Retailers Organization was put together. They would meet one day a week to talk about the market. Did not discuss prices. I was invited to meetings and finally went to one meeting. At no point did anyone talk about how they raised the prices. But someone was watching that these meetings were taking place. No one talked about prices. But the waitress was wired and everyone that was there was charged. I was asked how do you determine what your price is, I drive around and decide what my price will be – competition. Quit advertising my price. I fixed it at the pump, if you want to know price come to the pump and look. They considered that price fixing. Called tacid coordination – collusion. Out of the18 people, I was never prosecuted. But some were fined $50,000 and as independents they had to lower their gas prices for the same period of time they had been meeting. That just about put al independents out of business. That is why these gentlemen will not talk about prices.

Recessed at 12:06 until 1:15 pm.

Reconvened at 1:50 p.m.

Rep Ramras called the meeting back together there will be testimony from Safeway,
Rep Bob Roses and
Ed Sniffen

Cherrie – Director of public and government affairs for Safeway.\
(Also Joe, Glenda, and Ray)

Ray Weston, Attorney for Safeway – Glenda Wood is director of fuel pricing nationally which includes the Alaska territory. I would like first of all to understand the testimony and know that one of the concerns is how public this information is going to be. Am I correct in assuming that the testimony is public.

Rep Ramras – yes and we may offer a setting where testimony may be more private. But it is public. Focus of our mission is why the price of gasoline runs up so rapidly but why it is so slow to return to normal pricing when price per barrel comes down. Suggested that gasoline came possibly through the Port of Anchorage. Who do you purchase your gasoline from Which refiner?

Ray Weston stated that he could not necessarily answer that. Can get back to you. We do bring some in.

Glenda Wood – they get most of their gasoline from Tesoro and Flint Hills. In southwest Alaska we get our gasoline through brokers and from a few different brokers in the state of Alaska.

Rep Ramras - give us an overview of Safeway locations and who provides gasoline. Take us through the state.

Jay – described the number of Safeways with fuel distribution and where they were located. One under construction in Fairbanks at University, Bently Mall has been operating for 3 years, D – under Fairbanks at University, Dahlstrom, 3 in anchorage and Juneau and 1 Ketchikan. And one at the new Bently Mall. Ketchikan come in on south And rest from rail belt.

Rep Hawker – you talked about the retail outlets and where is the market nationally.

Glenda – gasoline stations in WA , OR, CA, Denver, Phoenix, Texas, Chicago and a few stations on the east coast. We are mainly a west coast operator.

Rep Hawker – in the past year the increases were added on but as price came down the price at the pump has not. Why does Alaska does not seem to pull back as quickly as the rest of the nation.

Glenda - in general the % up and down is similar for each of the regions we market in. In the last 30 days she is not sure.

Rep Hawker – across the states you operate in even though the increases were radical, was the highs and lows relatively consistent.

Glenda – volatility has never been seen before, I have been in this business over 20 years. Prices are higher and lower much more rapidly. Difficulty in trying to price competitively across the US and Canada. It is a nation-wide problem, not just in Alaska.

Rep Hawker – since you operate in WA as well as Alaska, a year ago in Alaska the average regular price was pushing $2.97 while WA was $2.54. About a 40 cents difference. A month ago, that margin was at AK $4.06 and $3.00 in WA. The differential had almost doubled what it had been a year ago. Do you maintain the analysis.

Glenda – we don't look at states differentially, but look at it as a whole. The rapid cost increases with the not so rapid cost decreases in all of our stations.

Jay - can you tell us how recently that occurred.

Rep Ramras – based the prices off Triple A price finder. Some significant price differences. We are trying to find out why the lag in pricing. Talk to us about pricing power vs those that don't. Talk to us about Safeway being a dealer and how you go about determining how much pricing power you have in a region.

Jay - in the discussions we have we don't think we have much pricing power at all. We survey our competitors.

Glenda - the cost is factored into it and with the costs substantially higher in Alaska. We are not a fully integrated refiner, we are buying gasoline from independent producers and they can decide how much they are going to pass on to the retail market. We buy at the best possible price we can and then we have to price accordingly.

Rep Ramras – are you saying the wholesale pricing is higher in Alaska.

Glenda – absolutely.

Rep Ramras – do you know why there is the variation or do you just accept the rack model and then price accordingly.

Glenda – basically the wholesale prices are higher because of the limited refining capacity in Alaska. A few refiners and are independent and their cost is higher as they buy their crude and then add on their markup and we buy at our contracted rates. Then there are the logistics getting the gas transported from the refinery to the retail unit. Higher transportation costs. Lack of refining capacity so the costs will be higher. A few of our stations get their gas outside of Alaska. So even though there is a lot of crude in Alaska, there is not a lot of refined product in Alaska.

Rep Hawker – there is a lot of motor fuel procured outside the state of Alaska shipped in. You are thinking more to the southeast and those areas accessed by barge.

Ray – we ship to southeast Alaska from Washington State. Not sure we can say definitively, but there is not a lot of competition. Those refiners are subject to the spot crude market too. They have to find it from the majors. So whoever refines crude has to pass those costs on.

Rep Gruenberg – if in fact one of the reasons for the higher price is the additional transportation costs, you pay the additional cost for everything you sell at Safeway, yet it seems that the cost of gas higher than the other items you sell.

Ray – it would take more analysis than we have done. Those things we sell do include a premium for transportation. We have to ship gasoline differently, because of regulation on how gasoline is shipped. We have not done the analysis to find out exactly what the cost differences are.

Rep Gruenberg – it seems that maybe the differences in price is due to the people in the petroleum industry and you may have put a finger on the price goes back to the transportation industry.

Ray – refiners price in Alaska is relatively high. Does not mean that transportation is reason for higher costs. We think limited refining is a problem.

Rep Ramras – North Dakota is similar to Alaska. Oil instate and a local refiner. When we looked at the price of North Dakota a year ago there was a small price difference, however there is now about a dollar difference in the price. We are trying to find out what would be the reason for that difference. Market price in Alaska is not necessarily the price set by the refiner, but the cost on the dock and then find a market price, where North Dakota sets the price from the different distributors that come into that state.

Ray – hard to imagine economically how the wholesale price in Seattle plus the cost of shipping would to some extent set the cost of what refineries are charging in Alaska. We have not done the research to confirm that.

Rep Hawker – just as a consumer living in Anchorage and you have a major fueling facility outside my area you have a great business model and a good job on a great run business in Alaska.

Rep Ramras – spoke to Safeway as a good corporate citizen and spoke about Glenn Peterson. Heard from an independent dealer that she sells about 700 gallons per week, non branded, and then we heard from Petro Star, they operate a number of facilities, they said gasoline would be a break even for them, they make their money on the inside purchases. How does Safeway see its gasoline sales. Is it seen as a lost leader.

Glenda – Safeway is in the gasoline business to sell groceries. It is supposed to be a customer convenience. Provide them with one stop shopping, so they can be more efficient. Customers liked the cents off on their gasoline.

Ray – but they are expected to show a profit.

Rep Ramras – ideally if I am a Safeway gas customer with brand loyalty. Am going to the store once a week and I go to your store and spend $300 and then purchase my gas at 20 cents below what is market price. Nature of it though it lowers the price of gas but the groceries are full price, but as I spend the $100. I get the discount. But the price at the gasoline pump should be basically the same as what other stations are priced at.

Ray – it is a reward for shopping with us. No fuel stations in North Dakota.

Rep Ramras - in the state of WA you have the same price, but then I get the discount when I shop there.

Glenda – basically they are all part of the Seattle division and we look at it as a whole. If gas price in WA is $3.56 but in AK $4.46 you are probably buying gas at about $1.00 difference. More competitive in WA.

Rep Ramras – fair to assume that refined gas is 90 cents cheaper in WA than it is here.

Ray – getting into an area that is very competitive and we would not want Chevron or Tesoro to know what our costs and margins are.

Rep Ramras – markets are competitive everywhere. We can assume that it is 90 cents different in Alaska.

Rep Ramras asked Rep Roses to share with the committee his experience as a service station owner in Anchorage.

Rep Roses - not sure what to talk about, but will share some history on price of gasoline. Typically what happened (2 stations) and built two car washes and gas was added feature. Did not want to give it away, but profit was car wash. Profit margin was 5 cents sometimes 3 cents. Selling it sometimes below what I had paid for it. To compete had to lower price. But get them on the lot and sell them the other products he offered. 20 years ago most stations were full service stations. Auto work, sold tires and lot of independents that owned the stations and so they had tradeoffs. There was full service and self service and a built in opportunity for other sales. There was Union 76 and the other was Tesoro we also had Chevron, and other places we could buy fuel. What I got was if I took a Union 76 card I did not have to pay a fee, other credit cards had to pay a fee. Each morning I would call to find out what the price of fuel was that day. Had to sell the fuel and always trying to find out if it was going up or down, this went on for about 8 months. Then a regulation passed where you had to be insured for 1 million dollars for spill.....virtually all independents went out of business. That is when Tesoro branded their own stations and then they would lease it to the person that used to be the independent. The underground storage tank regulations put more people out of work. Call to find out what the price was for the day, drive around and see what the others were charging and then price your gas accordingly and competitively. There is not a profit structure in gas, you are not going to be in business; it is too regulated, too restrictive and you can't make it if all you have is gas.

Rep Ramras – whatever the prevailing price is – is not the driver. Profit margin can be with distributors and refiners and how competitive that network is. The smaller it is the tougher it is.

Rep Roses – consider transportation costs. There was price for fuel and the transportation cost was included. But for the one in Wasilla there was a distributor that would load at the port and deliver fuel and was buying at relatively same price, but it was costing 5 cents more to have it delivered. So price was higher.

Rep Ramras – Rep Chenault talked about stations right beside refinery on Nikiski and then to North Pole – should be same.

**Lisa Sundborg, Alaska Petroleum.** - we deliver wholesale and retail fuel. We purchase from two refiners Flint Hills and Petro Star. We purchase gasoline from Flint Hills and some heating oil, and primarily buy #1 and #2 heating oil from Petro Star. We have about 17 trucks and go to the refinery and load and deliver and collect. Gas station went out of business – could not compete. Can't compete with big box prices. Gasline on the Steese. Haul to Prudhoe Bay and south. To enter the market you need a lot of money to purchase fuel. Our profit is at 14%. We deliver to Riverview Quickstop and our own station.

Rep Ramras – markup on distributor is not high.

Lisa – at our gas station at pump $4.19 or $4.20 and we purchase it without tax at about $3.77 and then the federal tax – would be about $3.95 and sell it for $4.20 and then you have to get it to the service station. The little bit of markup is still over what they are charging at Fred Meyers and Safeway. Does not know the reason for that. Heard it is lost leader.

Rep Roses – as a fellow gas station friend in business. Have you seen the cost of liability insurance and all that is included in transportation increase?

Lisa – there is no aspect of the trucking business that is not higher. All the things are impacted just because of the increase in fuel.

Rep Roses – when you deliver to the other station – you base your price on what you paid for it, then what you charge them, and they are trying to sell it for what they paid for it and then it might be lower, but you try not to have to lower your price, but then no one comes in and buys the gasoline.

Ed Sniffen - explained what the AG's office is doing and had a question that he asked Lisa. You buy ultra low sulfur from Flint Hills and you purchase heating fuel from Petro Star and Flint Hills, why is that?

Lisa – well it is about the same price, but the difference is how long you can hold off payment. And that is the difference in the purchase.

Ed Sniffen – do you perceive competition between the refineries?

Lisa – credit terms are driving issue. Product – Petro Star does not make nor distribute the ultra low sulfur or unleaded gasoline. We deliver fuel to Flint Hills.

Lisa - we have some home fuel deliveries but our only gas stations are Riverview and our own Gasline. Tesoro gets its own fuel from their own producer; Chevron has its own agreements. Could be selling to independents, but they are better off to buy brand. My credit terms may not be attractive. There are not a lot of independent stations.

Rep Ramras – asked for an update on the Attorney General's investigation.

Ed Sniffen – given direction from AG to look into these issues and did so right away. Made contact with retailers, refiners and distributors to try and figure out the bubble issue. We have received good cooperation from everyone. Flint Hills is responding as is Tesoro. Made some contact with Chevron, because I need to know why other gasoline retailers are not bringing up product from outside. One of the things we look at is something called import parody. Term used to describe what it would cost a competitor to bring fuel up here and get in the market. If Flint Hills and Tesoro find that prices are really high, an independent would just barge fuel up. Import parody drives pricing decisions here in Alaska. Keep the prices below parody so other independents do not get into the market. What would it cost someone to get into doing something like that. Provided a chart that dealt with the rack rates for fuel. He referred to the chart (Section 2) comparison of unleaded prices after taxes for Anchorage, Fairbanks and Seattle. Absolute price and bottom graph shows Anchorage, Fairbanks and Seattle price. It is the price that drives the import parody. Generally from 2002-2008 prices in Anchorage and Fairbanks have paralleled with Seattle. So lots of the testimony we have heard – those things have been the same for many years and the graph shows what the trends have been. The big spike that goes down and we don't know why that happened. Fairbanks was lower than Anchorage and lower than the rest of the country. Generally our prices parallel the Seattle and national averages. Compares Anchorage and Seattle with prices of ANS Crude Oil Prices before taxes. This graph shows that the prices have followed the ups and downs of the ANS crude price. Just to show that the percentages have remained the same. But the last chart is the comparison of rack to retail – U.S. average is the zero line. This shows what the retail margins are from rack to pump price. Green line is Seattle and retail margin spike up and down and are much more volatile than Anchorage and Fairbanks. When you get to the end in 2008, the national average is going up and Seattle is incredibly high. This shows us that the problem is not the price from rack to retail – it is the rack rate. Average was $4.02 but in Seattle it was $3.90. That is high. Sometimes 50 or 60 cents but it does not hold for very long. But at 90 cents it is very unusual and we are confident that the price has to do with the refining issues. Does not think that distributors and retailers are colluding and making lots of money. So we are trying to figure out why the rack rates are what they are. If you go back through the last decade all the things they are saying are issues, have always been issues – so that is not the answer. If it is an operational issue it would have happened before. There is something unusual going on and is very unique to Alaska. We are narrowing our focus on rack rates. Less concerned with retailers and distributors. Meeting with Flint Hills, Tesoro and Chevron and will have a better sense for what this bubble is caused by. Discussion about selling the royalty oil cheaper, but would have to make sure that it stayed in-state or it could be sent out and a lot of money made on it. In June of this year prices started coming down but Fairbanks and Anchorage kept going up.

Rep Coghill – surprise to me was importing for local refinery from foreign source. What is coming in that might affect rack price.

Ed Sniffen - at the end of 2002 Alaska was an exporter and believes that is still true today. Tesoro is possibly still exporting today. Between Anchorage and Fairbanks that is about 70% of gas usage.

Rep Ramras - it is my intention to let the Speaker know that we are going to prepare a report and within 30 days have another meeting, it is my intention to host a meeting every 30 days until we see a congruence and disparity reduction done.

Rep Coghill - agreed at least until we find a credible reason for an answer to give our constituents.

Rep Ramras - we will meet in Anchorage and if we have to go to Kenai and try to bring some light to this issue.

Rep Gruenberg - spoke with Ed Sniffen and wondered if he would share about some possible legislation.

Ed Sniffen - there is not a price gouging statute. Not sure that would resolve the issue. Have to figure out when it would trigger, even if you had economic duress. Asked laws in other states to come together. Other issue is we do not have a penalty section in anti trust laws now. Federal law does, all other states do. If there is a violation it is a misdemeanor. They are all prosecuted, but having an anti trust penalty provision would be helpful. It would be something that they could bring forth in legislation.

Rep Gruenberg - wants to see that followed through and also have a confidentiality provision.

Rep Coghill – lets see some other study put into it, but am not ready to get to that point.

Rep Ramras - lets see what happens within the next 30 days. Rather than make a motion now, lets wait and see. Lets anticipate that in 30 days we will look forward to tracking these and have a few more graphs and see in the near term. We could have a report and see how we end up with recoupling with in-state pricing. Then with that news try and find a way to close the gap.

Rep Coghill - there is a huge disparity and I have a refinery in my district and we pay some of the highest prices. We need some answers.

Rep Ramras – the bill from the Judiciary Committee would be a good direction for us to go. I learned a lot today. Thanked Rep Roses for his testimony.

Rep Gruenberg – do anti trust issues go beyond the petroleum issue. Since I have served in the legislature it has not happened, but I don't know if the legislature has ever looked at that. Maybe it is time to look at the best anti trust laws.

Ed Sniffen - our laws are like the federal law. Penalty provisions in the statutes are lacking but otherwise we mirror federal law. We don't get into a lot of anti trust issues here, but there are a few things that pop up, but have not had a need to focus on them and strengthen them.

Rep Kawasaki – asked for timeline.

Ed Sniffen – we don't have a specific timeline yet. Last time it took us three years, when we asked for info we got 350 boxes. We are trying to get info from just this year. Saying that, we are hopeful that we will have preliminary findings by the end of the year.

Rep Kawasaki – how do the refineries establish their rack prices; how do you investigate that?

Ed Sniffen – want to know what it costs to produce a unit as far as what the different costs are. Find out what costs vary from year to year. Oil prices go up and down. But what happens in the refinery that would change that causes the rack price to change. Based on that information we can get a good idea on why it would cause a producer to change their rack prices.

There was a discussion about how the rack price is figured and what the AG's office is trying to do.

Rep Ramras made final comments about what the goal of this meeting is, what is trying to be accomplished. There will be a report on the findings.

Rep Gruenberg – a report might make a suggestion on what the next legislative session could do and what it should look at. It would be a good guide for the next two years.

Rep Ramras - next meeting will be at the Anchorage LIO and will take up the parity on the rack rate.

Adjourned at 4:02 p.m.

**ALASKA STATE LEGISLATURE**
**HOUSE JUDICIARY STANDING COMMITTEE**
Fairbanks, Alaska
September 10, 2008
9:14 a.m.

**MEMBERS PRESENT**

Representative Jay Ramras, Chair
Representative Nancy Dahlstrom, Vice Chair (via teleconference)
Representative John Coghill
Representative Max Gruenberg
Representative Lindsey Holmes

**MEMBERS ABSENT**

Representative Bob Lynn
Representative Ralph Samuels

**COMMITTEE CALENDAR**

OVERVIEW(S): MATTERS PERTAINING TO THE HIGH GAS AND HEATING OIL PRICES IN ALASKA AND WHY GAS PRICES HAVE FALLEN IN THE LOWER 48 BUT NOT IN ALASKA

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

LOIS HEIN, Co-Owner
Riverview Quick Stop, Inc.
North Pole, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

REPRESENTATIVE DAVID GUTTENBERG
Alaska State Legislature
Juneau, Alaska
**POSITION STATEMENT:** Asked questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

CLYDE (ED) SNIFFEN, JR., Senior Assistant Attorney General
Commercial/Fair Business Section
Civil Division (Anchorage)
Department of Law (DOL)
Anchorage, Alaska
**POSITION STATEMENT:** Provided comments and answered questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

REPRESENTATIVE MIKE HAWKER
Alaska State Legislature
Juneau, Alaska
**POSITION STATEMENT:** Provided comments and asked questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

JANE W. PIERSON, Staff
to Representative Jay Ramras
Alaska State Legislature
Juneau, Alaska
**POSITION STATEMENT:** Responded to a question during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

REPRESENTATIVE BOB ROSES
Alaska State Legislature
Juneau, Alaska
**POSITION STATEMENT:** Asked questions and provided comments during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

JEFF COOK, Director
External Affairs
Flint Hills Resources
North Pole, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

REPRESENTATIVE SCOTT KAWASAKI
Alaska State Legislature
Juneau, Alaska
**POSITION STATEMENT:** Asked questions and provided comments during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

DOUG CHAPADOS, President

Petro Star Inc. (PSI)
Anchorage, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

KIP KNUDSON, Manager
External Affairs
Tesoro Alaska Company
Anchorage, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

RAY WEST, Senior Corporate Counsel
Safeway, Inc.
Pleasanton, California
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

GLENDA WOOD, Director
Pricing and Promotion
Safeway, Inc.
Pleasanton, California
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

JOE GULLEY, Manager
Denali District
Safeway, Inc.
Anchorage, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

LISA SUNDBORG, Office Manager
Alaska Petroleum Distributing Inc.
Fairbanks, Alaska
**POSITION STATEMENT:** Provided comments and responded to questions during the presentation on matters pertaining to the high gasoline and heating oil prices in Alaska.

**ACTION NARRATIVE**

**CHAIR JAY RAMRAS** called the House Judiciary Standing Committee meeting to order at 9:14:06 AM. Representatives Gruenberg, Dahlstrom (via teleconference), Holmes, and Ramras were present at the call to order. Representative Coghill arrived as the meeting was in progress.

Overview(s): Matters pertaining to the high gas and heating oil prices in Alaska

9:15:29 AM

CHAIR RAMRAS announced that the only order of business would be consideration of matters pertaining to the high gas and heating oil prices in Alaska and why gas prices have fallen in the Lower 48 but not in Alaska.

CHAIR RAMRAS relayed that he and Representative Harris have discussed the issue of rising retail gasoline prices and whether they are the result of "pricing power" in the market or of inefficiencies in the market due to volume issues - consumption [volume] or production [volume]. He offered his recollection that antitrust issues were investigated during the Knowles Administration, and the Department of Law (DOL) concluded that the pricing situation at that time was not due to antitrust behavior but was simply the result of the market. He mentioned that the hearing today would be largely informational; that Mr. Sniffen from the DOL would be providing an overview of the State's current ongoing inquiry into these matters; that a follow-up hearing would be held in about a month; that the House Judiciary Standing Committee will be producing a report for the legislature; and that energy issues and the cost of fuel oil, gasoline, and natural gas are of importance to constituents.

9:21:32 AM

LOIS HEIN, Co-Owner, Riverview Quick Stop, Inc., relayed that a couple of weeks ago she'd called for delivery of gasoline but couldn't get it because of a slow-down in production, and therefore had to "bag off" the pumps at her station. Upon contacting Alaska Petroleum Distributing Inc. and Big State Logistics, Inc., she discovered that "if we couldn't get gas through the refinery, we were going to have to ship it in by rail car," which would result in increased cost to consumers at the pump. Not having gas at the pumps during bad times, she remarked, makes things even worse, and these are very difficult times right now. She noted that her customers have signed a petition against the high price of fuel in Fairbanks; they are distressed that gasoline prices across the nation are going down as is the price per barrel of oil and yet those decreases aren't reflected in the price they are paying at the pump.

MS. HEIN noted that there had been a $.20 decrease in the price of [gasoline] a couple of weeks ago, as well as an $.08 decrease when the governor's legislation repealing the State's motor fuel tax took effect. She expressed favor with the investigatory efforts being undertaken, adding that many people feel that they have no recourse, and that she is seeing a lot of people who are going to have to move. In response to questions, she indicated that many people signed the aforementioned petition, and that she would be providing the signed petition to the committee and to Governor Palin.

CHAIR RAMRAS said the committee would include a copy in its forthcoming report and forward a copy to the "appropriate state agencies."

MS. HEIN relayed her comfort with that proposal, adding, "I would like to be able tell the people, who are asking daily, that they do have a voice, [that] ... the State works for them - ... we aren't forgotten little people." In response to questions, she explained that her company buys gasoline from Alaska Petroleum Distributing Inc, the vendor from the refinery, and that there have been no previous problems getting gasoline.

9:25:42 AM

REPRESENTATIVE GRUENBERG noted that his research indicates that other states are considering "anti-gouging" legislation, though the protections in a number of those pieces of legislation are only triggered by the declaration of a state of emergency. One state, however, has considered broadening the definition of a "state of emergency" to include an "economic emergency". He asked Ms. Hein whether she thinks it would be appropriate for Alaska to do something similar.

MS. HEIN indicated that she thinks that the current situation could be considered an economic emergency, adding that she is aware of people who are not able to pay their utility bill and their fuel bill and their rent. Furthermore, prices in the grocery store are rising, and vendors are raising their prices three to four times a year as well. "It's affecting everything right down the chain," she remarked, adding that people just can't afford "to live here." In response to further questions, she said that every week the price of gasoline has been going up; that her company has been having difficulty buying product because she couldn't afford to pay that much more to the gasoline company every week; that in the last year, for example, the cost of gasoline has risen close to $1/gallon; and that currently the price of gasoline at her pumps is $4.38/gallon.

CHAIR RAMRAS asked Ms. Hein what her "margin is" per gallon, what the fees currently are for credit card users compared to a year ago, and what volume of gasoline she sells compared to other retail gas stations associated with large stores.

MS. HEIN said that her company has a markup of $.20/gallon; pays [$.05/gallon] on credit card purchases; and used to sell about 700 gallons/day but now only sells about 300 gallons/day. She said she assumes that this drop is due to people driving less. She noted that she charges about $.20 more per gallon than some gas stations located in town, such as "Fred Meyer," "Safeway," and "Holiday."

9:30:35 AM

REPRESENTATIVE DAVID GUTTENBERG, Alaska State Legislature, asked Ms. Hein whether, when her distributors told her that gasoline was not available, she was given a reason why production was down.

MS. HEIN said she was simply told that there was a problem at the refinery, and only discovered later that production had stopped.

REPRESENTATIVE GUTTENBERG asked whether that was due to the refinery making less gasoline in favor of making more jet fuel.

MS. HEIN said she was not given that information.

REPRESENTATIVE GRUENBERG offered his understanding that Section 3 of North Carolina's proposed House Bill 653 expands the definition of "disaster" to include "economic well-being".

CHAIR RAMRAS indicated that the committee would be pursuing these issues well into October and on into the next legislative session.

9:34:52 AM

CLYDE (ED) SNIFFEN, JR., Senior Assistant Attorney General, Commercial/Fair Business Section, Civil Division (Anchorage), Department of Law (DOL), relayed that he focuses on enforcing Alaska's consumer protection and antitrust statutes, and that although he was not in that position when the aforementioned previous gasoline-pricing investigation occurred, he was when the final report was issued. That investigation, which looked at gasoline pricing in Alaska from the mid-1990s to 2000, focused on whether there was anything illegal about the pricing, and the report concluded that there was not. The attorney general is now again looking at those issues.

MR. SNIFFEN relayed that although he is sympathetic to concerns that the high price of gasoline is causing people to think about leaving Alaska, it also raises the questions of, "What do we want to do about it?" and "What can we do about it, from a legal perspective?" For the most part, [the State] doesn't control what prices businesses set for their goods and services; there is no law that says businesses can only sell their products at cost plus a certain amount of profit. Instead, [the State] relies on the market to set prices; businesses sell their products for whatever consumers are willing to pay for them. One of the unfortunate aspects of gasoline is that the demand for it is relatively inelastic regardless of price. Lacking an [adequate] public transportation system in Alaska, people have to buy gasoline in order to travel to and from work, for example, particularly in the winter months. This inelasticity regarding demand seems to have a huge impact on pricing.

MR. SNIFFEN suggested that one way to help the market drive prices down would be to lower the demand for it, though that could prove to be difficult. Another thing to consider is whether there is anything illegal going on with regard to gasoline pricing. Alaska currently doesn't have a "price-gouging" statute - the State can't simply tell a business that it is charging too much for a product. Furthermore, price-gouging statutes in other states are all triggered by a declared state of emergency - when Hurricane Katrina hit, for example, there was a declared state of emergency, and [Louisiana's] price-gouging statute prohibited businesses from raising prices during that state of emergency and thereby taking advantage of consumer fears - so even if Alaska did have a similar statute, it probably wouldn't apply under the current circumstances.

MR. SNIFFEN relayed that although a price-gouging statute triggered by economic strife of some kind might be warranted in Alaska, he is leery about having legislation interfere with market forces. He acknowledged, though, that such would be a policy call for the legislature to make. Alaska's antitrust laws, on the other hand, also help to control pricing in a peripheral manner, and are aimed at keeping the market competitive. The State doesn't want competitors colluding with each other or doing things that disrupt the normal operation of the market. Fair competition drives prices down, and benefits consumers. Alaska's antitrust laws are limited in scope in that they target exclusionary conduct and conduct that suggests that price fixing or coordinated activity has occurred. From an antitrust perspective, the DOL will look to see whether businesses are colluding with each other in some way to keep the price of gasoline at a certain level, or whether individual businesses are attempting to exercise market power in an illegal fashion in order to keep gasoline prices high.

9:41:22 AM

MR. SNIFFEN said that when it comes to the pricing of goods and services, the legal remedies are narrow and few. When there is no collusion or other illegal antitrust conduct occurring, and the market is operating competitively, then prices are simply what prices are; it's really just a supply-and-demand world, and supply and demand affects prices. One reason for the recent shortage of gasoline in the Fairbanks area, he surmised, pertained to an operational issue at the refinery - some components required in the manufacture of gasoline had to be repaired and it took several weeks for that to occur. Such operational issues can account for spikes [in supply and therefore price].

CHAIR RAMRAS offered his understanding that Tesoro Corporation, as a publicly traded company, lost 75 percent of its market value over the last year; and that research indicates that that's due to a lack of pricing power at the refinery level - that as the price of gas goes up, consumption goes down, and so refiners lose their margin. He said he's heard arguments that had the price of gasoline truly followed the price of a barrel of oil, the price of gasoline might have gone as high as $6.00/gallon. Consumers, he surmised, related the price of gasoline to the price of a barrel of oil and thus assumed that there should now be a correlating decrease in price. After referring to the Healy Clean Coal Plant (HCCP), Chair Ramras said that he'd met with the CEO of Golden Valley Electric Association (GVEA), and offered his understanding that GVEA estimates the price of oil going forward 90 days, missed a "radical" move in the market and so lost over $25 million, and has since only been able to recapture $2.5 million of that loss every month and thus it will take GVEA 10 months of price correction to recoup the total $25 million. Consumers, on the other hand, see only that the price they are paying has not correspondingly dropped with the drop in the price of a barrel of oil. He relayed that GVEA has indicated that it will have to recoup the aforementioned $25 million loss before it can "re-price" [its rates] to correlate with the [current] cost of diesel, which generates the majority of [GVEA's electric] kilowatts.

CHAIR RAMRAS, remarking that the state is somewhat responsible for the high price of oil because it's selling its royalty oil at the premium price that the market will bear, asked Mr. Sniffen to speak about "pricing for retail customers ... and the disconnect that may exist between [the] price of a barrel of oil, the relationship to refining, and how long consumers have to wait until that relationship is restored."

MR. SNIFFEN, suggesting that representatives from the refineries might be better able to respond to those points, relayed that the administration has retained the services of a petroleum economist - Barry Pulliam, senior economist at Econ One Research, Inc. - and that he and Mr. Pulliam have discussed the fact that the retail price of gasoline did not correspondingly go as high as the price of a barrel of oil, thus resulting in a deficit for some refineries, which in turn have delayed decreasing their prices until they can recoup their loses. Historical data regarding the price of gasoline in Alaska's Railbelt communities - Anchorage, Fairbanks, Kenai - illustrates a trend for the price of gasoline to lag a bit behind "what the market has done." Even Seattle, for example, lags behind the national market, and Alaska lags even a bit further behind.

MR. SNIFFEN remarked that the current lag has been particularly long, and that even when the prices elsewhere started to fall, the prices in Alaska still have not, even a month later. Mr. Pulliam, Mr. Sniffen relayed, has indicated that perhaps some other operational issues in Alaska have been a factor in keeping prices in Alaska up. Mr. Sniffen said that [he and Mr. Pulliam] will be investigating that point further. Mr. Sniffen suggested that the fast and dramatic increases in the price of a barrel of oil caught everybody off guard, and so it may be awhile before prices come down further, though the suspension of the State's motor fuel tax has resulted in a bit of a decrease.

9:49:19 AM

CHAIR RAMRAS referred to a chart in members' packets which illustrates average gasoline prices, gasoline prices a month ago, and gasoline prices a year ago, in Alaska, Idaho, Montana, North Dakota, South Dakota, Washington, and the U.S. as a whole. He remarked that North Dakota is similar to Alaska in that the population is small, it's rural in nature, there's no population density, it's an oil exporter and an oil producer, and has one refinery. Consumers in Alaska, he remarked, have put forth the argument that since the state owns the oil, they ought to be able to purchase it for less. Chair Ramras expressed interest in having Mr. Pulliam testify during the next hearing on these issues, as well as in obtaining information from states with characteristics similar to those of Alaska.

MR. SNIFFEN, in response to a question, proffered that the current high cost of gasoline in Alaska might be causing some people to purchase their gasoline at stations that have cheaper prices. So although the volume of gasoline sold at Ms. Hein's station, for example, has decreased, he doesn't know whether the total volume of gasoline sold in the Fairbanks area has necessarily decreased. He surmised that in some communities where residents have the ability to cut down on consumption, there has been a decrease in consumption. Consumption has gone down even in Anchorage, for example, but only by a small fraction, nothing large enough to have affected [retailers'] pricing decisions.

REPRESENTATIVE GRUENBERG asked whether Alaska has developed any common law that would remedy "this."

MR. SNIFFEN offered his understanding that if prices rose to an unconscionable level, that there is a "rule of equity" which might allow the argument to be made that a business's pricing is so outrageous that it's unfair and thus shouldn't be allowed. He added, however, that he hasn't ever seen that [argument] successfully applied to the price of gasoline. In response to a question, he indicated that in cases where that theory has been raised, there has almost always been a better theory raised as well - such as that fraud or a consumer protection violation occurred that resulted in the unconscionable price - and so the fact of a high price alone has not been the focus [of any subsequent investigation]. In response to another question, he observed that almost all consumer protection statutes are code-based.

9:54:59 AM

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, remarked that there is precedent for the state to regulate the price of essential life services via the Regulatory Commission of Alaska (RCA), so the state could simply regulate all refining and distribution of petroleum products. Should something like that occur, he asked, would that result in consumers having to absorb the entirety of such losses as those mentioned earlier? In other words, would the price of petroleum products simply go up even higher under a regulated environment?

MR. SNIFFEN surmised that that could be a possibility. He noted that when Hawaii put its refineries under regulatory control a few years ago, prices went up right away to the maximum allowed by statute and then never came down. Doing something similar in Alaska would be very difficult, he opined, and mentioned that Mr. Pulliam had been involved in coming up with Hawaii's regulatory framework. Under Alaska's current regulatory regime, if a utility company wants to set a price for delivery of its gas, it has to go before the RCA for a rate hearing. So if the refineries in Alaska had their rates set by the RCA, and something happened whereby they incurred a lot of costs, they would either have to seek some emergency relief from the RCA or wait until their next regular rate hearing before adjusting their rates and trying to recover their loses. This would be difficult, he again opined, because crude oil markets move far more dynamically than those associated with other types of energy utilities that the state already regulates.

REPRESENTATIVE HAWKER asked whether the courts have ruled that the state may not sell its royalty oil below market price.

MR. SNIFFEN said yes, adding that there is also a constitutional requirement for the state to sell its royalty oil at market rates so as to maximize the state's resources for the benefit of the people, and companies like Tesoro Corporation and Flint Hills Resources must pay the price set in the world market.

REPRESENTATIVE HAWKER, referring to the aforementioned chart, asked whether the column listing taxes includes excise taxes.

10:01:41 AM

JANE W. PIERSON, Staff to Representative Jay Ramras, Alaska State Legislature, said that that column just lists sales taxes.

MR. SNIFFEN, in response to comments and a question, offered his understanding that when a refinery manufactures a gasoline product, it goes to various types of gas stations in a variety of ways. For example, there are company-owned gas stations that are affiliated with the refinery in some way - they may be leased through the company that owns the refinery, or they may be "branded" stations, which have to comply with certain requirements - and then there are some independent gas stations that use various distributors to transport fuel to them from the refinery. Furthermore, some independent gas stations might have the resources to buy their own fuel trucks, and so will just go pick up their own fuel.

MR. SNIFFEN indicated that most gas stations, though, have some kind of a relationship with a refinery - via some kind of agreement, which might include a reduction from the "rack rate" - and have gas delivered through various types of transportation companies. Pricing decisions are primarily left to the retail stations, and are clearly driven by the refinery's price for gasoline at the rack, which is the term used for the outlet at the refinery where the gasoline is sold and picked up by the fuel trucks. A rack rate is what the refinery is selling its gas for at the rack, various services track rack rate information for refineries around the world, and the administration is using Oil Price Information Service (OPIS) to track rack rates as part of its investigation.

MR. SNIFFEN explained that jobbers are entities that transport fuel from the rack to the different stations, and are related to the gas stations owners and the refineries in some way. There are also independent distributors that own fuel trucks and transport fuel to anyone who needs it, charging so much per gallon for that service.

REPRESENTATIVE COGHILL, remarking that his father worked as a jobber, offered his belief that jobbers have "brand loyalty."

MR. SNIFFEN concurred.

10:09:30 AM

REPRESENTATIVE BOB ROSES, Alaska State Legislature, asked Mr. Sniffen whether he was familiar with "the antitrust prosecution that occurred against independent service station owners back in the '70s."

MR. SNIFFEN said he is familiar with that prosecution as well as with an investigation that occurred in the early or mid-'90s in which it was found that there was some collusion occurring, though he is not sure whether the subject of that investigation was indicted or subjected to criminal penalties.

REPRESENTATIVE ROSES, referring to the [prosecution] that occurred in the '70s, explained that the State brought a lawsuit against 18 different service station owners and that there were about 30 stations involved because some of the people under investigation owned several stations. This occurred back when there were gas shortages all over the country, and [as one of those service station owners, he'd] get calls from his distributor five times a day saying that the price of gasoline had changed again. During those times, if a service station owner was lucky enough to buy 10,000 gallons of gasoline at one of the day's low prices, then he/she could actually make a profit, but if not, then he/she would end up "giving it away" in order to stay competitive with other service stations. Representative Roses explained that he was one of the aforementioned 18 service station owners.

10:12:33 AM

JEFF COOK, Director, External Affairs, Flint Hills Resources, paraphrased from his written testimony, which in part read [original punctuation provided]:

> Our Company has more than 60 years of experience in the refining business. Along with the North Pole Refinery, which we have owned since 2004, we also own and operate refineries in Minnesota and Texas.
>
> The North Pole Refinery began operating in 1977, shortly after the TransAlaska Pipeline System was completed. The facility has gone through various modifications over the years, but its basic configuration has remained unchanged. Our refinery is a topping plant meaning it lacks the sophisticated processing capability to turn all of the crude oil that comes into the plant into refined products.
>
> The North Pole Refinery takes in between 180,000 to 220,000 barrels per day of crude oil. We heat that crude oil to distill it into a few basic products which we retain to sell. The rest of the stream is then returned to TAPS. As a result, we keep only about 50,000 barrels a day of saleable products, the majority of which is jet fuel. In addition, we keep a

quantity of fuel that is used to heat the crude oil in the refining process.

There were many topping plants operating in the United States when the North Pole Refinery opened for business in 1977. Now, there are just a few. Increased environmental emissions regulations caused many topping plants to shut down and increasingly stringent federal requirements on the type of fuels produced forced others to close.

The North Pole Refinery was able to keep pace with new environmental regulations but the changes in the type of fuels required has impacted the amount of gasoline that can be produced at our North Pole plant.

Since federally mandated decreases in sulfur content for gasoline and diesel fuel came into effect in the last few years, our ability to produce those two fuels has been substantially diminished. While the refinery still produces some gasoline and off-road diesel, we now buy gasoline and diesel fuel from other sources in order to meet the full needs of our customers.

We are not in the crude production business nor do we own retail stations and all of our products are sold on the wholesale market.

It's also important to note that we provide less than one-fifth of the gasoline used in Alaska and only a third of the heating fuel in the Fairbanks area.

10:16:17 AM

CHAIR RAMRAS offered his understanding that Flint Hills Resources is contemplating taking "draconian measures" because it is having a difficult time staying in business and has ongoing tension with the State, that most refineries are able to use natural gas to refine their products into gasoline; that the price of natural gas is equivalent to oil at about $45 per barrel; and that Flint Hills Resources is still using oil to refine its products into gasoline, resulting in more cost compared to the refinery at Nikiski, which, he said he assumes, uses natural gas.

MR. COOK relayed that Flint Hills Resources has to refine its crude oil into the product - basically, gasoline - it uses to run its refinery in North Pole, so the high prices of crude oil have definitely impacted the company. Most refineries in the country do run on natural gas, and this puts the North Pole refinery at a competitive disadvantage. It costs about $21/MMBtu (million British thermal units) to run that refinery.

CHAIR RAMRAS offered his belief that "usually the energy equivalent between natural gas and oil is six to one"; that the current price of natural gas at the Henry Hub is about $7; and that the current price of Alaska North Slope (ANS) crude oil will be about $100 per barrel. If there was natural gas in Fairbanks, would Flint Hills Resources be able to refine its product for less, he asked. And, if so, would Flint Hills Resources pass that savings on to the consumer?

MR. COOK said that if that natural gas were to be priced similar to what it's priced in the Anchorage area, it would certainly reduce his company's costs significantly, though long-term market forces are what define price.

CHAIR RAMRAS surmised that if Flint Hills Resources were to change the type of fuel it uses to refine its product, it would result in future savings for consumers. He offered his understanding that 1 Bcf/year would supply the Fairbanks market, and that Flint Hills Resources would use about 5 Bcf "in order to swap natural gas for the function that oil is playing in refining products at the topping plant."

MR. COOK, in response to questions, indicated that some of his company's proprietary information could be provided to the legislature as long as confidentiality agreements were signed.

10:22.06 AM

REPRESENTATIVE HAWKER asked what it would cost to convert the North Pole refinery so that it could use natural gas to refine its products.

MR. COOK said he would try to provide that information to the committee.

REPRESENTATIVE GRUENBERG raised the issue of "zone pricing," and noted that proposed legislation in New York would make such illegal; that legislation - NY A 2641 - in part reads: "PRICES SET PURSUANT TO THE PRACTICE OF ZONE PRICING, WHEREBY A WHOLESALE OR RETAIL DISTRIBUTOR OF MOTOR FUELS SETS PRICES ON THE BASIS OF GEOGRAPHIC REGIONS, SHALL BE DEEMED TO BE

UNCONSCIONABLY EXCESSIVE AND SUCH PRACTICE OF ZONE PRICING SHALL BE PROHIBITED." Representative Gruenberg asked Mr. Cook whether he's heard of zone pricing taking place in Alaska.

MR. COOK said he has not.

10:24:23 AM

REPRESENTATIVE SCOTT KAWASAKI, Alaska State Legislature, asked how Flint Hills Resources determines what its rack price for heating fuel will be.

MR. COOK said that there is no specific formula that's used, and that market forces set the price and Flint Hills Resources must remain competitive in order to stay in business.

REPRESENTATIVE ROSES offered his understanding that zone pricing pertains to businesses that can access refineries in more than one state, and is therefore not an issue in Alaska.

10:27:11 AM

DOUG CHAPADOS, President, Petro Star Inc. (PSI), paraphrased from his written testimony, which in part read [original punctuation provided]:

> Petro Star was incorporated in 1984 and became a wholly owned subsidiary of Arctic Slope Regional Corporation (ASRC) in 1987. In terms of companywide refining capacity, Petro Star is, by a wide margin, the smallest in-state refiner and the only one that is owned and controlled by Alaskans. ...
>
> Today Petro Star operates two refineries. North Pole is our original plant and has a crude oil processing capacity of 20,000 barrels/day. Our second plant is located in Valdez and has a crude oil processing capacity of 48,000 barrels/day. These very simple topping units produce military and commercial jet fuel and, with increasing restrictions, home heating oil and diesel fuels.
>
> In addition to refining, Petro Star also markets fuel to end users in Interior, South Central, and Western Alaska through our North Pacific and Sourdough Fuel divisions. It is important to note that while we refine crude oil, we do not produce gasoline. The

gasoline sold at the eleven convenience stores we operate statewide is purchased from third parties. For this reason, Petro St[illegible] 's just like any other gasoline retailer. ...

It is part of Petro Star's culture to be good corporate citizens. We employ approximately 290 Alaskans, more than half of whom reside here in the Fairbanks area. Our remaining employees can be found in the other communities where we do business - Kodiak, Unalaska, Valdez and Anchorage. Almost all of ASRC's 9,600 shareholders - our owners - live and work in Alaska. We provide economic benefits in the form of employment opportunities which positively impact Alaska's economy, and by acting as a good community partner.

Petro Star is very aware of, and sensitive to, the negative impacts of high fuel costs on Alaskans. A large majority of o r employees and their families live in areas where energy costs are extremely high. It is mostly out of necessity that Alaskans live energy intensive lifestyles, and we recognize that high energy costs fall especially hard on the residents of this state. High costs have also opened the fuel industry to criticism, but we consider it a privilege to provide this essential service, especially in the more isolated regions of Alaska. ...

The challenges facing refiners across the country are growing and this is especially true for small refiners like Petro Star. Increasing environmental regulations, such as the proposed carbon tax and the ongoing implementation of low sulfur fuel standards to name but two, pose significant economic challenges for our company and undoubtedly will impact the prices Alaskans pay for fuel in the future.

Modifying just one of our small refineries to produce ultra-low sulfur diesel is estimated to cost substantially more that it did to build the refineries in the first place and we are now in the process of deciding whether this huge investment can be justified and what our options are if it can't. ...

Record high crude oil costs are a mixed blessing; on one hand they provide substantial revenue to the state treasury and help grow the Permanent Fund, yet these same high crude oil prices also create very real hardships for Alaskan families and businesses, and impose drag on our nation's economy.

Though admittedly a short term solution, Petro Star views the Resource Rebate as a positive step and can report that we immediately implemented another provision of this legislation by passing along the savings from suspension of the State Motor Vehicle Fuel Tax to our customers.

While the last few years have been good for Petro Star, our business is volatile and good years are often offset by bad ones. Being small, Petro Star does not have the same economies of scale enjoyed by our larger competitors, and while we always price our products to be competitive, we are not in a position to dictate the prices we pay for fuel or the market prices of the products we produce.

Petro Star has deep roots in the state of Alaska and we are committed to providing superior and competitive services to our customers. We take pride in our ability to successfully compete in the Alaska marketplace and look forward to a continued positive relationship with our customers, the communities in which we do business, and the State of Alaska.

10:32:19 AM

CHAIR RAMRAS asked whether having access to natural gas in Fairbanks would reduce Petro Star's production costs, and whether the same would be true if there was natural gas available in Valdez.

MR. CHAPADOS said natural gas would be cheaper than the fuels Petro Star currently burns at its refineries, but pointed out that there is some limit with regard to how much natural gas could be used to supplant the existing fuels. For example, there are components in the crude oil stream - when crude is processed in the refinery - that are not practical to return to the pipeline, and so those components are burned as refinery fuel. Petro Star could take advantage of natural gas prices, but not to the extent that it might at first appear. In response to a question, he explained that low-sulfur fuel standards are part of the Clean Air Act, began taking effect in

Alaska June 1, 2006, and address the sulfur content of diesel fuels and gasoline. In response to another question, he concurred that refined fuel is a value-added product, and characterized it as a significant contributor to the state's economy.

MR. CHAPADOS, in response to other questions, explained that fuel-quality standards are set at the federal level; that Petro Star has been designated by the Environmental Protection Agency (EPA) as a small refiner; that that designation allows Petro Star to delay complying with federal low-sulfur fuel standards for roughly four years, but limits the volume of high-sulfur fuels - such as diesel for off-road use and heating oil - that it can sell from its two refineries; that the volume caps that were imposed on Petro Star were based on years when the company sold less volume; and that as a consequence, Petro Star must now truck product from its refinery in the Interior down to Southcentral Alaska, and truck product from it's refinery in Southcentral up to the Interior, thus incurring greater cost, which it must recoup. He mentioned that it is far more efficient and cost effective to transport fuel by barge than by truck. In response to another question, he indicated that the aforementioned delay in having to comply with the federal low-sulfur fuel standards was the result of input from the state regarding the distinction between urban and rural areas of the state.

10:39:27 AM

REPRESENTATIVE HAWKER questioned whether low-sulfur standards are really necessary in Alaska or whether it's just a case of Alaska getting swept up in the national trend.

MR. CHAPADOS indicated that those standards should be applied in Alaska because modern vehicles that are designed to burn ultra-low-sulfur diesel cannot burn high-sulfur diesel. In response to comments and a question, he explained that prior to implementation of low-sulfur diesel standards, all refiners in Alaska could produce "highway diesel fuel," but now the only in-state refinery that is now capable of producing ultra-low-sulfur diesel fuel is the one owned by Tesoro, and that [conversion] did not come cheap to Tesoro. In contrast, Petro Star has a limited ability to produce what is known as low-sulfur diesel fuel, but, again, Petro Star is also limited with regard to the volume it may sell.

CHAIR RAMRAS asked Mr. Chapados what Petro Star's profit margin is with regard to the sale of gasoline at its 11 convenience stores.

MR. CHAPADOS declined to provide that specific information. He added that in general, Petro Star is seeking to be competitive with other gas stations near its retail locations and at least break even on its "gasoline volumes"; Petro Star makes more money on the other products it sells at its convenience stores that it does on gasoline sales.

10:45:23 AM

REPRESENTATIVE KAWASAKI asked how Petro Star calculates its rack rates.

MR. CHAPADOS said Petro Star is seeking to be competitive, adding that his company won't sell heating oil to other distributors, for example, if its prices aren't competitive.

REPRESENTATIVE KAWASAKI asked Mr. Chapados if he could prove that Petro Star is passing on to consumers the $.08 savings resulting from the repeal of the State's motor fuel tax.

MR. CHAPADOS agreed to get that information to the committee.

REPRESENTATIVE KAWASAKI expressed concern that because gasoline goes from a refiner to a distributor and then to a retailer, that that savings has not been passed on to consumers and is instead simply being absorbed somewhere.

MR. CHAPADOS indicated that he would be providing information which illustrates that his company's prices dropped by $.08 as of September 1, 2008. In response to comments and questions, he explained that jet fuel is typically sold to large commercial or military entities and so retail prices are tied to published indices regardless of what a barrel of crude oil is selling for on the global market. He relayed that during that period when the cost of a barrel of oil increased so dramatically, Petro Star did not pass on that increase to its heating fuel customers.

CHAIR RAMRAS offered his belief that the public perception is that "everybody in the chain" did exceedingly well during that time period and engaged in bad behavior and took advantage of the situation. The goal of the committee, he relayed, is to determine why, as the price of a barrel of oil comes down, there is not a commensurate decrease in the retail price of gasoline.

MR. CHAPADOS said his sense is that that increase in the price of crude oil was not passed on in its entirety. In response to a question, he explained that heating oil makes up the smallest part of Petro Star's sales.

REPRESENTATIVE COGHILL questioned whether Petro Star, if it no longer had the military bases in the Interior as customers, it could start selling more heating fuel to people in the Fairbanks area.

MR. CHAPADOS said it could not because of the aforementioned volume caps pertaining to high-sulfur diesel; the only other outlet for that product would be to truck it all down to Anchorage as jet fuel.

CHAIR RAMRAS remarked that Alaska's fuel market is fragile and tied to the military, and noted that when he'd spoken of the problems facing Flint Hills Resources to someone in the administration, that person indicated that Petro Star would simply buy Flint Hills Resources. All refineries have a fragile nature, he concluded, and are not making vast amounts of profit as is assumed by the public.

REPRESENTATIVE COGHILL asked what the state's gasoline needs are and whether it is necessary to import gasoline into Alaska to meet those needs.

CHAIR RAMRAS offered his understanding that Southeast Alaska must get its gasoline from Seattle.

10:54:49 AM

REPRESENTATIVE HAWKER asked whether the commitment from the U.S. Department of Defense (DOD) to require a conversion from regular diesel fuel to synthetic fuel at Alaska's military basis will threaten the fuel industry's stability in the state.

MR. CHAPADOS said it is a threat.

REPRESENTATIVE HAWKER surmised that the state would have to build new refineries to accommodate such a conversion, and that the resulting costs being passed onto retail consumers will get even worse.

CHAIR RAMRAS indicated that an example of a synthetic fuel would involve converting "coal to liquids." He surmised that a closure of Eielson Air Force Base would also pose a threat to Petro Star.

MR. CHAPADOS concurred.

CHAIR RAMRAS relayed that he would like to hear comments regarding a proposal to limit the price of crude oil for in-state use, and what effect that would have on the prices of gasoline and home-heating oil.

10:58:23 AM

KIP KNUDSON, Manager, External Affairs, Tesoro Alaska Company, referring to his PowerPoint presentation, said that Tesoro's Kenai refinery [in Nikiski] was first started in 1969 and is now heavily integrated with the community, and suggested that members should look at the refining industry as the most successful value-added industry that the state has ever had. He relayed that Tesoro Corporation is an independent refiner and marketer - with the Kenai refinery remaining what he called the legacy asset - and is publicly traded as TSO on the New York Stock Exchange (NYSE).

MR. KNUDSON indicated that Tesoro Alaska Company has three major elements: the refinery, a distribution network, and its retail sites. The Kenai refinery's "nameplate" capacity is 72,000 barrels per day, though it never operates at that capacity, and it has over 200 employees and an award-winning safety record recognized nationwide. The Kenai refinery is what he called a "medium-complexity refinery"; it makes several different products, and production volume is increased via the addition of catalysts. Of the seven products that the Kenai refinery produces, there are three - heavy vacuum gas oil, fuel oil/bunker, and road asphalt - that don't really have any market in Alaska, and thus one-third of the plant's production has to be exported. About 50 percent of the Kenai refinery's crude oil supply comes from the North Slope, about 25 percent comes from Cook Inlet, and about 25 percent comes from foreign sources - illustrated on slide 6 of his PowerPoint presentation - because the refinery can't currently buy enough crude from Alaska sources to satisfy its demands.

MR. KNUDSON relayed that Tesoro was the first company hauling crude oil and refined products into the state to use double-hulled tankers, currently charters two tankers with a capacity of roughly 500,000 barrels each, and has exceeded regulatory requirements by stationing a chartered "assist tug" at its Nikiski dock to help tankers on and off the dock. He indicated that slide 9 of his PowerPoint presentation illustrates the paths that the Kenai refinery's product takes in terms of supply and distribution. The Kenai refinery has racks at Nikiski for asphalt, propane, butane, gasoline, and diesel, and has a 70-mile, 10-inch, "clean products only" pipeline that runs from Nikiski up to the port of Anchorage and - via a spur line - the Anchorage airport.

11:06:14 AM

CHAIR RAMRAS asked whether Tesoro sells product only to Tesoro distributors.

MR. KNUDSON said Tesoro will sell product to anyone who will buy it. After noting that Tesoro has two terminals at the port of Anchorage, he indicated that slide 12 of his PowerPoint presentation references the 31 convenience stores owned by Tesoro - 29 of which sell fuel under the "2go" logo - and Tesoro's 58-plus branded dealers. Acknowledging that consumers are extremely frustrated with the high price [of gasoline], he offered the following contributing factors: the cost of the raw crude oil, the cost to refine that product, the cost to distribute that refined product, the cost of marketing, taxes, and [the influence of] competition. Furthermore, there will be fluctuation daily with regard to which of those factors is contributing most heavily to the retail price, though the cost of crude oil constitutes "the lion's share" of costs to the company.

MR. KNUDSON observed that Tesoro is in a commodity business; it buys a commodity, that being crude oil, and sells a commodity, that being gasoline and heating oil, both of which are traded on the mercantile exchanges, which in turn - to a large extent - have some influence over what retail consumers are paying. Tesoro, he assured the committee, is not "in a cost plus business"; just because the company has costs doesn't mean that those costs will ultimately be recouped via sales. Several [global] factors influence the price of crude oil, and thus it is hard to predict what that price will be from month to month.

MR. KNUDSON explained that refining and distribution costs are based on global and regional factors: regional factors within the state, regional factors in the state "writ large," West Coast factors, and world factors. On the issue of environmental regulations, he relayed that Tesoro invested $60 million in the sulfur-stripping process at the Nikiski refinery just to essentially stay in the diesel business, and this investment won't be increasing production amounts at all. That same investment had to be made just to stay in the gasoline business; furthermore, an additional capital investment will have to be made in the future in order to meet [forthcoming] new requirements regarding benzene levels. These are all external forces influencing the retail price of the product.

11:11:06 AM

MR. KNUDSON offered his belief that as the state's natural gas pipeline moves forward, it will be difficult to keep [employees at the refinery]. The market sets the price, he went on to say, and referred to slide 15 of his PowerPoint presentation as illustrative of those things that influence the market. In response to a question, he said that the graph on slide 16 shows that Alaska has a very small market for motor fuel [compared to some other western states].

CHAIR RAMRAS asked that the committee be provided a similar chart with comparisons between Alaska and Idaho, Montana, North Dakota, and South Dakota.

MR. KNUDSON agreed to do that, adding that Alaska's small market is a contributing factor with regard to how the market performs. He explained that jet fuel "is king in Alaska"; that's what the refineries in Alaska were built to produce in order to satisfy the international jet fuel trade at the Anchorage and Fairbanks airports. Gasoline and diesel fuel, to a certain extent, are simply byproducts of those refineries. Additionally, the Alaska market shows more "seasonality" even when compared with the West Coast. The times when one wouldn't want to be either a refiner or gas station owner are February, April, and November.

MR. KNUDSON, referring o slide 18 of his PowerPoint presentation, emphasized that retail prices are set by retail station owners, and Tesoro only controls retail pricing at its 29 convenience stores that sell gasoline, and has no influence over the prices at any of the other stations in the state. Retail prices also respond to differing local conditions. Again, the Alaska market is very small and very seasonal. He relayed that Tesoro, under confidentiality agreements, will be working with Mr. Sniffen to provide him the information he is seeking.

REPRESENTATIVE ROSES asked how Tesoro's price structure changed after the adoption of Alaska's Clear and Equitable Share (ACES) legislation.

MR. KNUDSON said passage of that legislation didn't affect what Tesoro is paying for its crude oil because that price is based on the global price, and the tax rate that producers pay is independent of that price. He indicated that after the recent repeal of the State's motor fuel tax, some retailers relayed to him that they were concerned that that repeal didn't take into account that they purchased their product when the tax was still owed but then didn't sell it until after that tax was repealed.

11:16:12 AM

REPRESENTATIVE HAWKER asked whether, when Tesoro buys a barrel of crude oil, Tesoro must then use all of it because it can't be put back into the pipeline.

MR. KNUDSON said yes, and reiterated that roughly a third of Tesoro's refined products must be exported to markets outside of Alaska; furthermore, those products generally sell at or below the price of the raw crude oil used to make them. In response to questions, he relayed that the percentage of foreign oil that Tesoro buys will be going up as production in Alaska declines; that the "crude buyers" at his company would love to be able to purchase more Alaska crude oil; and that up until the late '90s, Tesoro was a big purchaser of the state's royalty oil, but doesn't purchase such oil now.

MR. KNUDSON, in response to further questions, relayed that the tankers which Tesoro contracts operate under the Jones Act; that Tesoro does receive shipments from foreign vessels; and that Cook Inlet is limited with regard to the number of barrels that can be onboard a vessel because of spill response requirements. He noted also that Tesoro has to use crude with a chemical signature similar to that found at the North Slope because it was around that signature that the refinery was built. In response to still further questions, he said that Tesoro uses natural gas in its refining process, and that each refinery has its own advantages and disadvantages in the market.

REPRESENTATIVE KAWASAKI asked how Tesoro's rack price is determined.

MR. KNUDSON said he doesn't know, but surmised that such information would be proprietary in nature and that Mr. Sniffen would be investigating Tesoro's rack pricing processing. Pricing is a market-driven opportunity, he added.

REPRESENTATIVE KAWASAKI, referring to slide 15, asked how the large spot market price in Seattle, San Francisco, and Los Angeles factors into Tesoro's pricing decisions.

MR. KNUDSON explained that those spot market prices are guidelines and are unbelievably fluid compared to market prices in Alaska; that those markets take in product from tens if not hundreds of refineries; and that the characteristics and swings in those markets don't always apply to Alaska, but are always taken into consideration.

11:25:26 AM

REPRESENTATIVE HAWKER asked how much of Alaska's demand for motor fuel Tesoro supplies.

MR. KNUDSON said he is not sure, and is also not sure that anyone at Tesoro is keeping track of those statistics. He offered his guess that Tesoro is a large player in satisfying Alaska's demand for motor fuel, but noted that imports can also have influence on retail price.

REPRESENTATIVE HAWKER surmised that it would be hard for someone to buy gasoline in Washington, ship it to Anchorage, and then be competitive with Tesoro.

MR. KNUDSON said he doesn't know that to be the case, particularly given that at some point, other refineries will also be producing ultra-low-sulfur diesel.

REPRESENTATIVE KAWASAKI asked Mr. Knudson to provide the committee with proof that the repeal of the $.08 motor fuel tax is being passed on to Tesoro's consumers.

MR. KNUDSON agreed to do so for Tesoro's 29 convenience stores that sell gasoline.

CHAIR RAMRAS - referring to the aforementioned chart which illustrates average gasoline prices, gasoline prices a month ago, and gasoline prices a year ago, in Alaska, Idaho, Montana, North Dakota, South Dakota, Washington, and the U.S. as a whole - questioned why there is such a great disparity in pricing between Alaska and other rural states with small populations.

MR. KNUDSON surmised that in that chart, Alaska's average price was calculated using the retail gasoline prices in both urban and rural communities - for example, averaging the retail price in Fairbanks with the retail price in Bethel.

CHAIR RAMRAS offered his understanding that instead the average prices for Alaska were calculated using only retail gasoline prices in Alaska's Railbelt communities.

MR. KNUDSON said, "It's market forces that have ... produced these prices, [for both] the price one year ago and the ... current [price]." He mentioned that he has a newspaper clipping stating that in March 2007, Anchorage had the nation's lowest gasoline prices.

REPRESENTATIVE HAWKER asked why Alaskans haven't seen a reduction in retail motor fuel prices similar to what occurred with the price of a barrel of crude oil over the last three months - a 46 percent reduction.

MR. COOK, reiterating that Flint Hills Resources provides less than one-fifth of the gasoline used in Alaska, concurred with an earlier statement that had the retail price of gasoline kept up with the price of crude oil, gasoline prices would have been closer to $6/gallon, or certainly a lot higher than they did get. Because the retail price of gasoline did not keep up with the price of a barrel of crude oil, he explained, Flint Hills Resources lost money during the majority of the last 12 months. Furthermore, even though the price of crude oil has dropped recently, it is still at an unprecedentedly high price, and so in order to stay in business, Flint Hills Resources can't afford to continue to lose money, particularly given that the costs of operating its refinery are also unprecedentedly high. He assured members that Flint Hills Resources would be providing, under confidentiality agreements, proprietary information to the DOL.

11:36:15 AM

REPRESENTATIVE HOLMES pointed out, though, that retail prices of gasoline have already come down everywhere else in the country, and they never got up to $6/gallon in those locations either.

MR. KNUDSON mentioned that over a year ago, he'd participated in an inquiry conducted in the state of Washington, wherein investigators went county by county, looking at the variability in retail gasoline prices within the state of Washington, and every county had different reasons for charging a particular price, and every county had finished product from a variety of different sources. Mr. Knudson surmised that Mr. Pulliam, when looking at Alaska's data, will be able to glean answers from the data, but he doesn't have the ability to do so. In conclusion, Mr. Knudson said it seems like the market is currently working the way it always has.

CHAIR RAMRAS remarked, "Certainly not for the benefit of the consumers." He asked what percentage of the state's motor fuel needs is being satisfied by Tesoro.

MR. KNUDSON said he doesn't know, and, even if he did, he wouldn't be able to divulge that proprietary information in this venue. In response to a question, he said that although one might be able to find out who is producing gasoline in the state, one wouldn't be able to find out who is importing it into the state, particularly given that there is nothing preventing someone from importing gasoline to any tidewater port in the state.

CHAIR RAMRAS questioned what would occur if a constitutional amendment were introduced [and passed by the voters] to put a cap on how much crude oil was sold for - from the state's royalty share - to [in-state] refiners for the production of gasoline and heating oil [for in-state use].

MR. KNUDSON said it would be difficult to predict what the results would be until such an amendment was actually passed.

CHAIR RAMRAS countered, "We certainly couldn't do it until you predicted what it would do."

REPRESENTATIVE COGHILL surmised that market dynamics, whether Alaska has the ability to sell [enough royalty oil to meet in-state demands], and the constitutionality of such a cap would all have to be considered.

11:42:12 AM

CHAIR RAMRAS asked at what point will the state itself have to buy oil from the producers in order to meet its contractual obligations.

MR. COOK pointed out that Flint Hills Resources is only allowed to have 85 percent of what it buys be royalty oil, with no more than 95 percent of that coming from any given field. Today, with the reduction in the Trans-Alaska Pipeline System (TAPS), and the aforementioned restrictions, if Flint Hills Resources were to demand the maximum amount of royalty oil it could, the state would be hard pressed to meet that demand; Flint Hills Resources is taking far less than its maximum allowable amount of 77,000 barrels per day.

MR. CHAPADOS, in response to a question, said that Petro Star gets its crude oil supply from one of the major producers.

MR. COOK, in response to a question, said that Flint Hills Resources takes in as much royalty oil as it has product demand to sell, and, because of the aforementioned federal restrictions, is at maximum capacity with regard to gasoline [production].

MR. KNUDSON said the production rate [at his company] is geared to meet market demand, and so [his company] doesn't want to make 25 percent more, for example, than there is demand for, one, because there isn't any place to store it and, two, that's just not good business. Furthermore, production [demand] changes daily and monthly.

11:45:11 AM

MR. CHAPADOS said that Petro Star's Valdez refinery runs very near capacity, and is doing some expansion in order to be able to process more crude oil. The North Pole refinery, because of the aforementioned federal restriction, doesn't run at capacity at all times. Petro Star is having to anticipate what its volumes of high-sulfur diesel and heating oil products will be, and so may have to either forego some sales or transport product down to Anchorage. "That has cut into our crude oil runs at that North Pole ... [refinery]," he added.

MR. KNUDSON, in response to questions, reiterated that Tesoro's Kenai refinery never runs at maximum capacity, but also doesn't want to have idle equipment, because a lot of plants don't run well when operating under capacity. He indicated that details with regard to Tesoro's output rates will be provided to Mr. Sniffen under confidentiality agreements. In response to a further question, he said he doesn't know how Tesoro's average refineries compare with other refineries in the U.S. with regard to unit costs.

REPRESENTATIVE HAWKER opined that such information is relevant. He indicated that he is questioning whether some of Alaska's costs are driven by a unit cost differential inherent in smaller refineries. He asked whether Tesoro's unit costs are consistent at all its refineries.

MR. KNUDSON said he would research that issue further.

REPRESENTATIVE HAWKER - referring to the aforementioned chart which illustrates average gasoline prices, gasoline prices a month ago, and gasoline prices a year ago, in Alaska, Idaho Montana, North Dakota, South Dakota, Washington, and the U.S. as a whole - pointed out that a year ago, the price of regular gasoline less taxes in Alaska was about the same as it was in North Dakota, where Tesoro owns the only refinery, whereas a month ago, the price of regular gasoline less taxes in Alaska was about a dollar more than it was in North Dakota.

11:50:47 AM

MR. KNUDSON said he doesn't know why that is.

CHAIR RAMRAS noted that with the recent decrease in the price of a barrel of oil, the retail price of heating oil has dropped in his area, but, again, a similar decrease in the price of gasoline has not occurred. He questioned what the difference is between those two types of fuel that would account for such a discrepancy.

MR. KNUDSON relayed that heating oil is a high-sulfur product whereas highway fuel is an ultra-low-sulfur product, so they are really two different products these days.

CHAIR RAMRAS clarified that his point is that market forces appear to have affected the price of heating fuel but don't appear to have affected the price of gasoline.

REPRESENTATIVE COGHILL asked how, if companies spent the capital to upgrade their refineries so as to be able to produce ultra-low-sulfur fuel, that cost would be passed on to the consumers.

MR. KNUDSON said he couldn't answer that question accurately today, but surmised that Mr. Sniffen would be investigating that issue in the near future. He remarked, however, that just because his company makes a capital investment, that doesn't mean that it will be able to just raise the price of fuel in order to recapture that investment - there is no connection between the two. In response to comments, he indicated that he wouldn't be able to say whether Tesoro Corporation tries to recoup costs incurred at its refineries in competitive areas of the nation through its prices in Alaska, where competition is not so stiff.

REPRESENTATIVE GRUENBERG offered his understanding that some other states have authorized - and provided funding for - their attorneys general to investigate these types of issues, and opined that the legislature would be well advised to try and get a handle on what the causes [of continued high retail fuel prices] are in Alaska, and investigate whether anything can be done to help keep costs down. He remarked that if they could figure out why [in March 2007] gasoline prices in Anchorage were the lowest in the nation, it could perhaps provide some clues as to how to make it happen again.

11:59:00 AM

MR. KNUDSON suggested that perhaps some Internet sites could provide some pricing data from that time. He remarked that although prices in the Lower 48 tend to go up and down much more sharply than they do in Alaska, "they always intersect over the long term - always."

REPRESENTATIVE GRUENBERG asked whether pricing is entirely random.

MR. KNUDSON offered his belief that to a very great extent, pricing is based on local market conditions, such as the number of retail sites, wholesalers, trucks, pipelines, and refineries there are in a particular local. In response to a question, he surmised that attempting to explain what the retail price of gasoline will be is the same as attempting to predict what the price of a barrel of oil will be. They are both a commodity and therefore subject to all kinds of market influences and factors only some of which can be charted, studied, estimated, and projected over the years.

REPRESENTATIVE GRUENBERG suggested that even a little bit more information would be helpful in attempting to solve the problem.

MR. KNUDSON predicted that when the DOL's investigation is concluded, it will show that there isn't really a problem; consumers may not like the price, but the market is performing as it should. He then referred to the aforementioned Washington investigation, and noted that although an unbelievable amount of data was analyzed, the conclusion was that the markets were operating as expected, regardless that they weren't predictable or understandable at every point in time.

REPRESENTATIVE ROSES relayed that back when he was a gas station owner, the prices were so volatile that a group of service station owners in Anchorage decided to form a gasoline retailers association. That group would meet to talk about what was occurring in the market, but didn't discuss price fixing. Representative Roses said he went to one meeting, and when he was asked at that meeting how he determined what price to charge, he said he simply looked to see what his nearby competition was charging, and when asked what he did about his signs, he said he stopped displaying prices because he was tired of having to change his signs several times a day. He indicated that his refusal to post prices was considered to be price fixing. Those of that group who were successfully prosecuted were required to lower their gasoline prices for the next six months. Representative Roses said that during that time, when he was competing with those stations that had had to lower their prices, he was selling his gas for $.04/gallon less than he paid for it.

The committee took a recess from 12:07 p.m. to 1:59 p.m.

CHAIR RAMRAS - after stating the committee's goal and recapping what transpired earlier in the meeting for the representatives from Safeway, Inc. - asked who provides Safeway stores in Alaska with gasoline products; in other words, which refiner do those products come from and what distribution source does Safeway use.

2:04:37 PM

RAY WEST, Senior Corporate Counsel, Safeway, Inc., said that some of the company's gasoline products come from out of state, and offered to research that issue further.

2:05:05 PM

GLENDA WOOD, Director, Pricing and Promotion, Safeway, Inc., relayed that in Alaska, Safeway gets most of its gasoline from either Flint Hills Resources or [Tesoro Alaska Company].

2:05:23 PM

JOE GULLEY, Manager, Denali District, Safeway, Inc., added that because of logistics, gasoline for the Safeway stores in

Southeast Alaska - Juneau and Ketchikan - comes through the Seattle distribution link.

MS. WOOD relayed also that in Southwest Alaska, Safeway stores get their gasoline through a couple of different brokers in Alaska.

MR. GULLEY, in response to a question, listed the Safeway stores in Alaska.

MS. WOOD, in response to questions, said that Safeway also operates gasoline stations in Washington, Oregon, California, Colorado, Arizona, Texas, Illinois, on the East Coast, and in Canada; that in general, the percentage that Safeway's retail gasoline prices rise or fall is similar in all of its retail markets; that in the last five years, market volatility has increased, and thus Safeway has had difficulty in all of its markets dealing with high costs while still pricing its gasoline competitively; and that Safeway prices its gasoline as a whole and doesn't differentiate price according to which state the gasoline will be sold in - but the company has seen the rapid cost increases along with the not-so-rapid cost decreases at all of its stations.

2:13:47 PM

CHAIR RAMRAS, in response to a question, relayed that for its chart that illustrates average gasoline prices, gasoline prices a month ago, and gasoline prices a year ago, in Alaska, Idaho, Montana, North Dakota, South Dakota, Washington, and the U.S. as a whole, the committee used information from the American Automobile Association (AAA) web site. That chart illustrates quite a difference in pricing in Alaska compared to other states in the [Pacific Northwest].

MR. WEST questioned whether the recent troubles at the Flint Hills Resources refinery might have had an impact on Alaska's prices.

CHAIR RAMRAS said the committee is specifically interested in the apparent lag in which prices in Alaska - compared to prices elsewhere in the country - are dropping back down to something considered normal. He asked for information about Safeway's "pricing power."

MR. WEST said he is not sure that Safeway considers itself to have much pricing power; instead, generally, Safeway simply surveys its competitors to determine how to price its product.

MS. WOOD added that Safeway also factors in the substantially higher wholesale costs in Alaska. In Alaska, Safeway purchases product from independent refiners who in turn have had to buy product from the secondary market; Safeway buys its product at the best possible prices from the independent refiners - though those prices are higher in Alaska than they are in other states - and then prices its retail product accordingly. In response to a question, she proffered that wholesale prices in Alaska are higher because of the state's limited refining capacity. The few refiners there are in Alaska are small and have to buy their raw crude from one of the major companies and then mark up their prices accordingly. Safeway buys refined products at contracted rates, but must then transport those products to its retail sites, thus incurring transportation costs. And when Safeway has to import its gasoline from out of state, Safeway's retail prices reflects those higher transportation costs. Most of the gasoline used in Alaska is not refined in Alaska, she noted.

MR. WEST, in response to a comment, reiterated that for its Ketchikan and Juneau stores, Safeway transports gasoline up from Washington. He remarked that in Alaska, there isn't a lot of competition among refiners, and that those refiners, just like refiners everywhere else, are subject to the "spot crude oil markets."

REPRESENTATIVE GRUENBERG said that if it were true that the transportation costs of Safeway's gasoline products are what results in higher retail prices, then those same transportation costs should also be affecting the prices of Safeway's other products, but that doesn't seem to be the case - the price of Safeway's gasoline is higher, proportionally, than the price of its other products.

MR. WEST offered his belief that most products that Safeway cannot source in Alaska do include a premium for transportation, though he is not sure how big that premium is or how it compares to [the one associated with Safeway's retail gasoline], particularly given that gasoline must be shipped differently due to regulatory requirements and other issues.

2:25:00 PM