

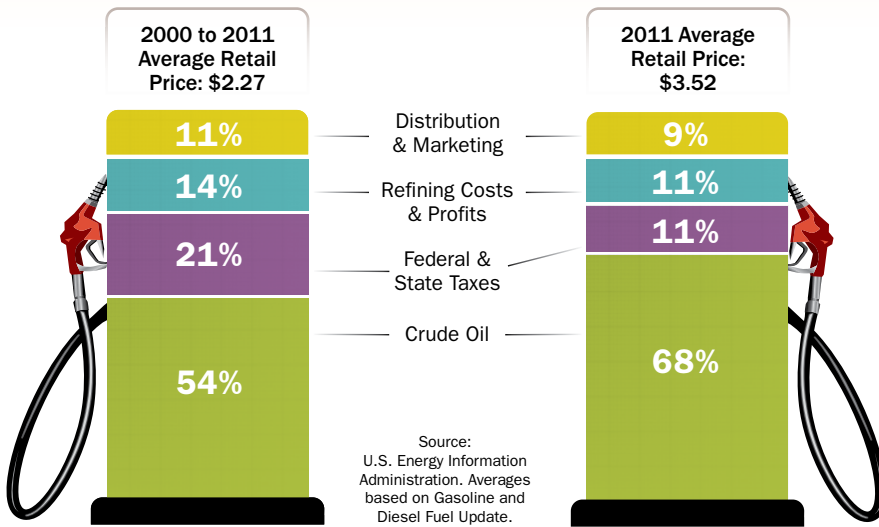
# straight talk

Alaska Oil and Gas Association



November 2012

## FUEL PRICE FACTORS What do we pay for in a gallon of regular-grade gasoline?



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## Explaining gas prices in Alaska

Why is gasoline so expensive in Alaska? It’s a question frequently asked by consumers. The answer is both simple and complex.

### First, the simple:

The market sets the price. Gasoline prices are determined by the forces of supply and demand. In a market economy, this is the foundation for how commodities are priced.

### Now, the complex:

There are a number of ever-changing factors as well as unique, fixed costs that can have a positive or negative effect on the price of gasoline in Alaska.

The main factors are:

- The cost of crude oil
- The cost of energy to run local refineries
- Dramatic swings in seasonal demand
- New fuel specifications driven by environmental regulations
- Market size and low retail-volume levels

### Cost of crude

On average, the cost of crude oil now makes up 68 percent of the cost of a gallon of gasoline nationally. Most of the oil used to produce

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Gasoline prices are determined by the forces of supply and demand. This is the foundation for how commodities are priced. Photo courtesy of Flint Hills.

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gasoline in Alaska is Alaska North Slope (ANS) crude. Flint Hills (as well as Petro Star, which doesn't produce gasoline) is designed to use exclusively ANS crude that is delivered to their refinery directly from the trans-Alaska pipeline. The Tesoro refinery in Kenai was originally designed to process the lighter, sweeter Cook Inlet crude oil, but has been forced to supplement its feed stock with mostly ANS crude and other more expensive and harder-to-acquire foreign crudes. Over the past two years, ANS crude oil has consistently been one of the most expensive crude oils in the country. While the high price of ANS crude greatly benefits Alaska's state treasury, it has a negative impact on the energy bills of everyday Alaskans.

### The cost of energy

The cost of energy to produce gasoline in Alaska is also a major cost factor. Both Petro Star and Flint Hills heat their crude units using fuels produced in the refining process. This requires them to pay crude oil prices for their heat and is another way that high ANS crude prices, while beneficial to the state treasury, raise the price of refinery products.

Tesoro has the option to use natural gas from Cook Inlet at its refinery. Unfortunately, Cook Inlet natural gas is becoming more expensive and scarce.

### Seasonal demand swings

A refinery works best when its production can be set at an optimal and consistent level year-round. In Alaska, this isn't an option. The refineries need to adjust their production to meet the low demands for gasoline during the winter and the high demand in summer, when Alaskans drive more.

### New environmental regulations

Complying with additional environmental regulations often leads to increased costs.

### Market size and low volumes

The same remoteness that makes Alaska so appealing also makes fuel distribution more costly, particularly in rural areas. Alaska has the lowest gasoline demand of all 50 states. This is a result of our small population and geographic isolation. The average retail gas station in Alaska sells approximately

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Photo: Judy Patrick

Kara Moriarty

## AOGA EXECUTIVE DIRECTOR MESSAGE: Policy drives business

Alaskans have been bombarded by 30-second sound bites and bumper stickers over the last several months, but oil and gas policy is rarely explained accurately in short political statements, so I'd like to highlight a few facts.

**Fact:** Alaska relies on a healthy oil and gas industry. For over 30 years, the state has relied on one industry to pay 85-90 percent of its unrestricted general fund. That's the fund that pays for almost every state service statewide.

**Fact:** Alaska has declining production. Five years ago, when Alaska adopted its production-tax system known as ACES, the forecast for production was about 675,000 barrels per day in 2012. Our current average is about 100,000 barrels fewer than that, despite oil prices being 70 percent higher than the price forecast five years ago. Alaska is the now the third-largest producer in the United States, falling behind North Dakota earlier this year.

**Fact:** Alaska still has a lot of oil to produce. Because production from the Arctic offshore is at least 12-15 years

away, policymakers should focus on getting the 5 billion barrels of recoverable oil that are literally right under our feet in Prudhoe Bay and Kuparuk.

**Fact:** Tax policy affects business decisions. If you were to define Alaska's North Slope oil and gas tax policy today, it is "entice then take." We can and should grow the economy so ALL Alaskans, not just the government bureaucrats, benefit from more oil production.

**Fact:** Oil companies are responding to the state's tax policy. The incentives and credits are attracting a few new companies to Alaska, whom we welcome, but we are certainly not experiencing any type of boom, but we should be. From 1977 to 2006, despite there being no requirement for a guarantee, thirty fields and satellites were developed on the North Slope, which has extended the life of the basin beyond its projection. Since 2006, only two new fields have come online.

Oil companies do not make decisions based on emotion. They respond to policies. Alaska can keep the same policy of "entice then take" and it will deliver the same result of less oil in the pipe. Or Alaska can change its policy and business will respond in a way that benefits us all. ♦

**EMPLOYEE SPOTLIGHT:**

**Janna Miller, Alyeska Pump Station 1 Operations and Maintenance Supervisor**

Born in Fairbanks, Janna Miller graduated from the University of Alaska Anchorage with a degree in civil engineering. She went to work for Alyeska in 1989 right after the Exxon Valdez oil spill, a tumultuous time to enter the oil and gas industry.

“I was 21 years old, in my first job,” she says. “I remember that there were a lot of people coming into Alyeska at the time from our owner companies. After the Exxon Valdez, it became apparent that the industry had room for improvement in

our spill response capabilities, so all these folks came over to enhance our engineering and maintenance programs. It was exciting. There was a lot of work going on to review what we had in place and enhance our testing programs.”

Janna’s first job was to analyze and revise the computer model for response to spills along the pipeline in the event of a guillotine failure, which is exactly what it sounds like. A guillotine failure could only be caused by an extreme event, such as direct hit by a meteor or sabotage. Even though such an event was unlikely, Alyeska was ready to respond if the pipeline were ever completely severed. Twenty-three years later, Alyeska and Janna are still focused on safety.

Oil is “pushed” through Trans Alaska Pipeline System (TAPS) by four pump stations placed along its long route, with a fifth standing by as a relief station. At mile marker zero in Prudhoe Bay, pump station one (PS01) is where it all begins. PS01 receives oil from all five producers’ lines, measures it and sends it south, where it is relayed by the next pump station and the next, all the way across the state.

“My duties are to keep the pipeline operating smoothly and make sure our people are trained in what to do during an emergency response. We have quarterly drills, including going out in the middle of winter when it’s dark round the clock and the wind is blowing. We simulate a spill somewhere out on the tundra and practice finding it, containing it and cleaning it up.”



*Alyeska Pipeline Service Company's Janna Miller at mile marker zero, Pump Station 01.*

Alyeska maintains more than 200 containment sites along the pipeline that are stocked with equipment needed for spill response. For example, containment sites near rivers contain booms to be placed across a river to stop oil from flowing downriver and pumps to clean oil off the water’s surface.

The American Petroleum Institute has honored Alyeska for its safety record several times over the years. This year, all Alyeska

employees and all of its contractors are in the top quartile of safety performance in the industry.

“We’re tickled pink to be there,” Janna says. “It’s just a tremendous accomplishment. The majority of people who keep the pipeline running are contractors. They’re the ones out there pounding the hammers, moving the cranes, doing the digging. They’ve got their hands deep into work that is not easy to do without getting hurt. To have them be in that top quartile is something that we are really proud of.”

Looking forward, Janna says, “We’re making a major investment in our infrastructure to keep the pipeline going for another thirty years. For example, we’re moving all the buried piping at pump station one to above ground so that it can be better maintained to guard against corrosion.”

The pipeline’s daily rate is roughly 550,000 barrels per day, which is down from the high of 2.2 million barrels per day at its peak. If production increases again, we can be confident that America’s treasure will be protected. Alyeska Pipeline Service Company and loyal employees like Janna Miller are ready to transport it efficiently and safely.

“I never thought I’d be working here for so long, but it’s been fun,” Janna says. “I have yet to run into somebody who works at this company who doesn’t care deeply about what we’re doing. There’s a lot of pride in working for TAPS. And people want to do the right thing. When you have that around you, it’s a place you want to keep coming back to.” ♦

Explaining gas prices in Alaska continued from page 2

42,000 gallons of gasoline per month. This compares with approximately 75,000 gallons per month for a store in Washington state. That means the station owner needs to recover costs at a higher per-gallon rate than a larger station would.

### Does it make sense to compare our prices to the prices charged in Washington state?

During a Senate Energy Workgroup hearing this summer, Alaska Assistant Attorney General Ed Sniffen said, “Trying to draw a connection between the cost of a barrel of oil or what they’re selling fuel for in South Carolina or Texas or Washington or California and what fuel is selling for here — it’s interesting to look at. It’s informative and, hopefully, it’ll help us get to some solutions, but at the end of the day, it’s the competitive pressures on this market that ultimately set the price for our energy products.”

### What can policy makers do?

Allow the free market to manage price. Government price controls or other government interference in the free market

serves no one’s best interest. Increased production both on the North Slope and in Cook Inlet will help push the market forces in the right direction. The Alaska State Legislature has already passed legislation to encourage increased production in Cook Inlet. This has been achieved with lower production taxes, targeted exploration credits and streamlined regulatory processes. As a result, there has been a resurgence of interest in Cook Inlet that has manifested itself in the form of two new jack-up rigs and the entry of Hilcorp Energy and Apache Energy into the basin. While the inlet may not return to the heydays of the early ‘80s, all indicators point to a brighter future than anyone could have predicted as few as three years ago.

### The final analysis:

Alaska’s refineries are an important piece of the state’s economy. Without local refining capability, Alaskans would be dependent on outside sources of energy that could be disrupted due to unforeseen world events or weather factors. AOGA supports our local refineries and the hundreds of well-paying jobs they provide for Alaskans. ♦

## LEGISLATION ALERT:

# New conservation plan for Alaska’s National Petroleum Reserve hamstrings development



Earlier this year, Secretary of the Interior Ken Salazar released a new draft conservation plan for Alaska’s National Petroleum Reserve (NPR-A). Members of AOGA, as well as industry leaders, members of Alaska’s Congressional delegation, state of Alaska leadership and others expressed disappointment in the plan because it locks up a huge amount of land that could be explored and potentially produce oil.

In recent years, oil companies have already begun surrendering their leases in the reserve because the geology wasn’t as expected, and access issues created by Salazar’s decision make development in the reserve more unlikely.

In the minds of Alaska Oil and Gas Association members and others, most of the NPR-A area should be open to

development because it was first set aside as a petroleum reserve and not a wildlife refuge. AOGA Executive Director Kara Moriarty says Salazar’s decision essentially puts the area into wilderness status. “Alaska is already home to more wilderness than the rest of the country combined,” said Moriarty. “This decision just makes it more difficult to tap into resources located on federal land.”

Moriarty said industry officials also objected to the plan because creating protected wilderness could prevent a future pipeline carrying offshore oil to the trans-Alaska oil pipeline. “When Shell and other offshore operators finally begin producing oil, their preference is to ship it through the Trans-Alaska Pipeline,” said Moriarty. “If the path for a connecting pipeline is blocked because of this plan, then it’s back to the drawing board for how to safely move this oil.”

There is still time to weigh in on the issue. The final plan is expected to be released in November, so concerned citizens can contact Secretary Salazar with feedback on the draft plan by mailing comments to NPR-A IAP/EIS Comments, AECOM Project Office, 1835 South Bragaw St., Suite 490, Anchorage, AK, 99508. ♦

## FACT CHECK:

# Oil fuels our Permanent Fund Dividend

A 30-year tradition, the Alaska Permanent Fund Dividend (PFD) is an annual payment to Alaska residents. Let's examine oil's role in creating this unique financial arrangement.

## Why was the Permanent Fund created?

In the 1970s, Alaskans realized that they were about to receive a great deal of money from oil when the pipeline was complete. They wanted to protect the windfall that was coming, but the state constitution did not allow for dedicated funds. In 1976, Alaska voters approved a constitutional amendment to establish the Alaska Permanent Fund. The amendment reads: At least 25 percent of all mineral lease rentals, royalties, royalty sales proceeds, federal mineral revenue-sharing payments and bonuses received by the state be placed in a permanent fund, the principal of which may only be used for income-producing investments."

The constitutional amendment set up a mechanism that would save oil money for future generations.

## How does the Permanent Fund make money?

Two words: oil and investments.

The Fund receives money from Alaska's mineral revenues, the bulk of which come from oil. That money is entrusted to the Alaska Permanent Fund Corporation, which invests the Fund's principal in stocks, bonds, money market accounts and real estate. Each year, the dividend distribution is calculated using a formula set in state law. The formula is based on an average of the Fund's realized income over five years in order to produce a more stable flow of dividend amounts from year to year.

## Where does the money deposited into the Permanent Fund come from?

Almost all Alaska oil production is on state-owned land, so the state receives revenue from four different sources: production tax, property tax, royalties and corporate tax. In 2011, the state received just over \$8 billion from oil and gas. Most of those revenues are unrestricted and go directly into a general fund to be used for state services like roads and public safety. However, at least 25 percent of all mineral royalties is deposited into the Alaska Permanent Fund. In 2012 alone, the Fund received \$915 million from dedicated oil deposits. ♦



## MEMBER PROFILE:

# Hilcorp Alaska



## Hilcorp Alaska

**Q:** What year did Hilcorp arrive in Alaska?

**A:** 2012.

**Q:** Where does Hilcorp operate in Alaska?

**A:** Cook Inlet Basin.

**Q:** Where else does Hilcorp do business?

**A:** Louisiana, Texas, the Rockies and currently expanding into northeast Ohio. Hilcorp recently signed an agreement to sell its assets in the Gulf of Mexico.

**Q:** How many employees does Hilcorp have in Alaska?

**A:** 260

**Q:** What type of exploration/new development plans does Hilcorp have for Alaska?

**A:** Hilcorp is currently focused on enhancing production from existing well structures. We are investing a lot of time and money into repairing our facilities and infrastructure to support a long-term development plan. As we progress with organic growth, we are also working to identify new opportunities that will enhance our overall production numbers in Alaska. Our activity level will remain high, and we plan on keeping multiple rigs working throughout the winter and beyond. ♦

**FACT:** An Alaskan getting PFD checks since the program began has received a total of \$34,243.

## Alaska Oil and Gas Association

The Alaska Oil & Gas Association (AOGA) is a business trade association that represents the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska.

**Our mission is to foster the long-term viability of the oil and gas industry in Alaska.**

Learn more about the issues facing the largest economic driver in the Alaska economy at [www.aoga.org](http://www.aoga.org). Sign up for our newsletters and follow us on Facebook and Twitter for the latest information on the oil and gas industry in Alaska.

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Photo: Judy Patrick

**Our member companies:** Alyeska Pipeline Service Company; Apache Corporation; BP Exploration (Alaska) Inc.; Chevron; eni petroleum; ExxonMobil Production Company; Flint Hills Resources, Alaska; Hilcorp Alaska, LLC; Marathon Oil Company; Petro Star Inc.; Pioneer Natural Resources Alaska, Inc.; Repsol; Shell Exploration & Production Company; Statoil; Tesoro Alaska Company; and XTO Energy, Inc.

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