

**Prepared Statement of
Kim Penner
at the
Legislative Hearing on Fuel Supply Shortages in the Upper Midwest
Energy and Water Appropriations Subcommittee
United States Senate
November 20, 2007**

Mr. Chairman:

Thank you for your invitation to participate in today's hearing and to discuss the refined products supply situation in North Dakota. My name is Kim Penner and I am Senior Vice President of Light Products for Flint Hills Resources. In that role, I am responsible for all marketing activities related to gasoline, diesel and jet fuel for our company.

Flint Hills Resources is based in Wichita, Kansas, and is a leading producer of fuels, petrochemicals and other petroleum products such as base oils for lubricants and asphalt. Our company employs more than 3,700 people who strive every day to create value for our customers and their communities. We primarily operate in the upper Midwest, Texas and Alaska. Since 2002, the company has expanded its operations through a number of capital projects totaling more than \$3 billion. Our focus is to operate facilities with a long-term perspective by reinvesting 90 percent of our profits back into the business, with a primary focus on compliance and safety.

Flint Hills Resources' culture is based on Principled Entrepreneurship¹, which means it strives to combine a solid commitment to acting with integrity and an unwavering desire to anticipate and cost-effectively satisfy customer needs and grow its businesses.

Our company has been supplying customers in the North Dakota market for many years. When compared to other fuel providers within the state, however, Flint Hills Resources is a relatively small supplier. Unlike others for whom North Dakota is a core market, our company's gasoline and diesel market share in the state is only 10-15%.

Refined products are produced at our Pine Bend refinery, which is located on the Mississippi River near Rosemount, Minnesota. The Pine Bend Refinery serves markets in Minnesota, Wisconsin, Iowa, Nebraska and South Dakota, in addition to North Dakota. This refinery has recently completed a larger-than-usual turnaround, which is what our industry calls scheduled repairs, replacements and additions. This recent turnaround at Pine Bend also included a major expansion to increase crude oil distillation capacity by approximately 50,000 barrels per day to help meet growing fuel demands in the Upper Midwest. Turnarounds generally result in a short-term reduction of output for a long-term increase in output.

Before directly addressing our recently completed turnaround, I would like to provide a broad picture of the North Dakota supply and demand balances to establish some greater clarity regarding the market. While subject to seasonal variations and production variances, the following estimates offer an overview of the inflow and outflow of gasoline and diesel supplies in the state.

- In addition to Tesoro's Mandan refinery there are three refined products pipelines that import product into the North Dakota market. There also is a pipeline that originates at the Tesoro facility with delivery points located in North Dakota and Minneapolis.
- We estimate in-state production at about 38,000 barrels per day of gasoline; the state's entire demand is estimated at 24,000 barrels per day, resulting in an excess inventory of about 14,000 barrels a day;
- Gasoline imports into the state average about 14,000 barrels per day, while exports out of North Dakota account for an estimated 28,000 barrels a day; and,
- Estimated diesel production in the state runs at about 21,000 barrels per day, while demand is estimated at about 27,000 barrels a day, presenting a shortfall of about 6,000 barrels a day; and
- Diesel imports into the state average about 18,000 barrels per day, while exports out of North Dakota account for an estimated 12,000 barrels per day.

These figures are subject to a host of circumstances, scheduled and unscheduled events, marketing decisions and production variances, but I wanted to share them with you because they are generally relevant in understanding North Dakota's recent supply difficulties.

Flint Hills markets products via two terminals owned and operated by Magellan. Our company delivers products into the Magellan pipeline at our Pine Bend refinery. Magellan delivers product to terminals in Fargo and Grand Forks, North Dakota, as well as other states in the region. We do not control physical delivery decisions for those terminals. Those decisions are made by Magellan.

The pipeline operators themselves are also subject to external supply rigors as well such as available supply, scheduled and unscheduled refinery turnarounds, natural events and increased consumer/commercial demand. For example, the increased number of unplanned weather-related refinery shutdowns earlier this year in the Midwest and Rocky Mountain region compounded terminal supply problems.

As I mentioned, we recently completed an extensive turnaround at our Pine Bend facility. While this project was indeed large, it was by no means unprecedented for this site or our company. However, we did face unforeseen challenges during this turnaround. A tank rupture in the summer prevented us from accumulating the amount of product inventory that we had planned and rain delayed our unit startup by 10 days at the end.

Our planning for a turnaround generally begins five or more years in advance of the activity. Extensive planning is required to minimize production down-time without compromising safety or compliance with laws. Extensive planning is also needed to arrange for the necessary skilled work force. While the Pine Bend refinery typically employs about 700 individuals, the size of the on-site workforce grew to 1,700 or more during sustained periods due to the addition of contractors needed for turnaround activities. With such demand for skilled workers, the companies we work with must also make substantial commitments to field a workforce of this size. If they have pre-existing commitments to other refiners, they may simply tell a refiner that they are unable to do the work at the time requested.

By the third year preceding the turnaround activity, the company begins ordering long lead time equipment and piping. Reactor vessels, cokers and other components of refineries that may be replaced during a turnaround are special order items that require substantial engineering and manufacturing lead time. Some of the equipment is massive, and must be delivered as close to the time of the turnaround as possible because of space and transportation logistics. In addition, an abbreviated period between the end of high summer fuel demand and the onset of winter also play a role in when turnarounds can optimally be scheduled.

As the time for the turnaround draws closer, the schedule of activities becomes more precise and the opportunities to change the schedule become more limited. By this time, the sequence of activities is set, the staging of contractors is set, and the arrival of equipment is set. Deciding to postpone at this point doesn't usually mean a delay of days or weeks, it generally means a delay of months, a year or even more. Such extended delays may simply be unacceptable from the perspective of safety and environmental compliance.

The goal of a turnaround is to replace equipment and materials before they fail, with an ample margin for safety. Monitoring of metal loss rates and unit performance is done regularly to determine when equipment and materials should be replaced, again with an ample margin for safety. As a refining and petrochemical company, Flint Hills Resources' first responsibility is to ensure that its employees, contractors and neighbors are safe, and that its operations comply with all laws and regulations. Thus, timely turnarounds are critical to maintaining safe, reliable operations and supplying markets efficiently.

Flint Hills Resources, as well as the refining industry represented by trade groups such as the National Petrochemical & Refiners Association, understand that Senator Dorgan wants to explore ways for the federal government to approve and/or coordinate all refinery shutdowns. We are concerned that an effort to prevent multiple, simultaneous shutdowns, no matter how sincere and carefully considered, ultimately result in delays to successful refinery turnarounds and could potentially result in refinery accidents or an unplanned shutdown that further decreases production.

Legitimate questions have been raised as to how we and other refiners communicate with customers and pipeline companies about turnarounds, and how we allocate limited supply among customers. While we do not communicate turnaround activity with our competitors on advice of legal counsel that this communication would be a breach of anti trust laws ó we do certainly discuss that information with our customers and pipeline companies in advance. We have contractual commitments to many of our customers, and they are alerted and served first, on an equitable basis, when supply is not sufficient to serve all customers. Other customers prefer the freedom to shop for the best price each day among Flint Hills Resources and its competitors, and do not have contractual commitments to purchase set supplies from our company. These customers are served after our contractual commitments are met, if there is sufficient supply.

In closing I want to commend Senator Dorgan for chairing and hosting this important hearing. By bringing together key stakeholders from industry and government, we can better understand the issues and work toward solutions. We look forward to talking with Senator Dorgan on his policy goals in this area and we hope to give him a boots-on-the-ground perspective of how regulations in this area might affect this market.

From Flint Hills Resources' perspective, we believe that many of these issues can be addressed through increased production capacity both regionally and nationally. To this end we are uniquely proud to have completed the expansion at our own Pine Bend Refinery and of the ability it provides us to supply additional products throughout the Upper Midwest.

Mr. Chairman, thank you for the opportunity to participate in this important hearing. I look forward to answering any questions you may have.