Twenty Questions on Trans-Alaska Pipeline System Tariffs
And State Pipeline Tariff Management Issues

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Thank you for the opportunity to testify today on petroleum pipeline tariff issues. Pipeline transportation arrangements are critical to petroleum development. For this reason, I commend this committee for its initial effort to explore this important subject last March, and for your follow-up today. I am testifying today on my own behalf.

Mr. Chairman, it is no secret that I believe that responsibility for State petroleum tariff policy formulation rightly belongs with a line agency, such as the Department of Natural Resources. In most areas of State governance, the Department of Law serves a client agency by handling legal matters under the direction of that agency. But in the case of pipeline tariff management, that's not the way it works. I believe recent developments on TAPS and the proposed natural gas pipeline combine to confirm the importance of ensuring that clearly considered policy goals and directives are driving State actions in this important area.[1]

In broad terms, the importance of TAPS tariffs to the State Treasury is outlined in an analysis I prepared in February 2007 for the *Alaska Budget Report* on fiscal impacts of the TAPS tariff cases before FERC and the State Supreme Court. Mr. Chairman, that report was by no means perfect. But to the best of my knowledge, at the time I prepared these estimates, those were the only comprehensive numbers out there. Strange as it may seem, despite the important effects of TAPS tariffs on State revenue and the time and energy the Legislature spent in 2006 looking at the petroleum revenue picture, the State had not published (and, I suspect, may not have performed) a comprehensive, quantitative assessment of potential TAPS tariff litigation effects on State revenue. I estimate that since I completed that report earlier this year, the State treasury has lost another $55 million due to excess TAPS tariffs, based on the difference between FERC and RCA tariffs.[2]

I therefore commend you for your efforts today and encourage you to look very carefully at what has happened since you met in March to learn about a FERC document that excoriated the TAPS Owners' defense of their high filed TAPS tariffs.

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[1] My comments are based on three decades of observation of North Slope petroleum development as a reporter, as a public servant (including six years on the inside as a policy analyst in the Governor's Office – three years working on budget and revenue issues and three years as a senior advisor to the Governor on oil and gas policy) and as a consultant.

[2] For background information on the basis of this estimate, see: Richard A. Fineberg, *Historical and Current State Revenue Loss Quantified: Difference Between RCA's 2002 TAPS Tariff Order And State's 1985 Pipeline Tariff Agreement Costs State More Than $400 per Minute*, Feb. 28, 2007 (prepared for the Alaska Budget Report; on-line at http://www.finebergresearch.com) .

At the March 5 hearing, Steve Brose, an attorney for the TAPS Owners, told you that the Feb. 16, 1007 FERC Trial Staff brief was just the view of one guy in Washington. That evidently wasn't the case. And Mr. Brose assured you that the TAPS Owners would be responding to the FERC Trial Staff brief "quite vigorously." Despite that defense, FERC Administrative Law Judge Carmen Citron's May 17 decision closely followed the arguments of the FERC Trial Staff and the TAPS Owners went down in flames. The judge recommended that the FERC reduce TAPS tariffs to levels near those ordered by the RCA. I'm not altogether surprised that the TAPS Owners declined to appear today.[3]

Since you last convened to consider this issue, attorneys for the TAPS Owners made another vigorous appearance in another venue: They appeared before the Alaska Supreme Court in Anchorage March 13 to appeal the challenge to the RCA's 2002 decision and order requiring the TAPS owners to reduce tariffs on in-state shipments to approximately $1.96 per barrel.[4] In my estimation, the TAPS Owners' appearance before the State Supreme Court was the latest example of their use of everything but the kitchen sink and meaningful ratemaking data to justify their unreasonably high tariffs. Here, too, their arguments were vigorous.

And no wonder: Whatever the TAPS Owners' odds of success before the State Supreme Court, a filed tariff in excess of just and reasonable rates enables the major TAPS Owners to retain hundreds of thousands of dollars per day that they would have to pay the State.[5] As a practical matter, it is often – if not always – more difficult to collect refunds after the fact than to collect the right amount in the first place.[6] Chalk up the lost refunds to another example of the price the State pays for its historical failure to respond with alacrity to the TAPS Carriers' high filed tariffs.

I believe the FERC decision is unusual in the remarkable degree to which Judge Cintron's decision lines up with the principal arguments of the FERC Trial Staff and the protesting shippers. For example, in setting out the methodology and in her findings and conclusions, the FERC judge adopted Anadarko and Tesoro's tariff numbers.[7] I can't

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[3] Presiding Administrative Law Judge Carmen A. Cintron, "Initial Decision," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No. IS05-82-002, *etc*.), May 17, 2007, *passim*.

[4] See: Regulatory Commission of Alaska, *Order Rejecting 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings; and Outlining Phase II Issues* (Docket Nos. P-97-4 and P-97-7, Order P-97-4[151] / P-97-7[110]), Nov. 26, 2002. (I have discussed the significance of this order in various articles posted on my web site since I initiated that enterprise in September 2004.)

[5] Two simple facts explain this problem: (1) For every dollar paid in tariffs, the State loses approximately $0.25. (2) Three major oil companies own more than 95% of TAPS and control a roughly similar share of North Slope production. For a producer shipping its own oil, excess tariff payments are an internal transfer payment, not a cash outlay.

[6] If Judge Cintron's Initial Decision stands, it appears that future tariffs will be lowered to approximately $2.00 per barrel, but the State will not be able to collect full refunds on the difference between that level and higher filed past tariffs. Rather, the refunds she ordered for 2005 and 2006 will be based on the difference between the filed tariffs for CY 2004 and the filed CY 2005 and 2006 tariffs. ("Initial Decision," p. 106.)

Filed tariffs in CY 2004 averaged approximately $3.11 – more than $1.00 per barrel above what Judge Cintron's order sets as the just and reasonable tariff for TAPS shipments. (See: *Historical and Current State Revenue Loss Quantified: Difference Between RCA's 2002 TAPS Tariff Order And State's 1985 Pipeline Tariff Agreement Costs State More Than $400 per Minute,* Figure 1, note 5.)

[7] "Initial Decision," p. 40.

assess for you the odds that the FERC itself will uphold Judge Cintron's May 17 Initial Decision. But I can tell you this: Since Tesoro launched its protest of TAPS tariffs at the Alaska Public Utilities Commission (predecessor to the RCA) in 1996, the TAPS Owners have lost every major challenge to their high tariffs.[8] In view of the foregoing, my guess – and my hope for the State – is this: At the end of the day, the Courts are likely to find that the law and the public interest lie with the protesting shippers.

Near the end of her May 17 decision, Judge Cintron devoted a few brief paragraphs to the State's primary argument in this proceeding. The State had argued that "[t]he State's protests of the TAPS Carriers' proposed 2005 and 2006 tariffs raise a single, simple question – can the TAPS Carriers charge vastly different rates for transportation of oil solely on the basis of where shippers take their oil after it leaves TAPS?"[9] Judge Cintron's decision concluded that her findings on behalf of the shippers rendered the State's principal argument in this case moot.[10] Judge Cintron also ordered that the

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[8] A quick summary of these decisions follows:

In its 2002 decision and subsequent orders on TAPS tariffs, the RCA upheld the protests of independent shippers that tariffs charged by the TAPS Owners were excessive. In doing so, the Commission rejected arguments by the State of Alaska and the TAPS Owners. In that proceeding, the State, represented by the Department of Law and its consultants, argued to the effect that TAPS tariffs filed under the 1985 TAPS Settlement Agreement serve Alaska public policy interests well and should remain in place.

The State joined the TAPS Carriers in appealing the RCA's 2002 decision; in January 2006, the Alaska Superior Court upheld the RCA decision "in all respects," rejecting the arguments of the Carriers and the State. The State subsequently withdrew from the TAPS Carriers' appeal to the State Supreme Court.

In December 2004, the State and independent shippers Anadarko and Tesoro (A/T) protested TAPS tariffs filed by the Carriers at FERC. The Department of Law has emphasized that the State's protest at FERC is based on different grounds from the protests brought by the independent shippers.

On Feb. 16, 2007, the various parties to the FERC proceeding filed their initial briefs with the FERC Administrative Law Judge, who is charged with the task of determining facts and laying out the principal arguments for the commission itself. Unlike the independent shippers, who argued that the filed tariffs were excessive, the State's principal argument was that the tariffs should be reduced because the different tariffs would be discriminatory and would therefore violate the Interstate Commerce Act. In the estimation of many observers the most notable brief was filed by the FERC Trial Staff, which supported the A/T position and rejected the arguments of the Carriers. The FERC Trial Staff took no position on the State's principal argument, arguing that a just and reasonable tariff at FERC would bring the FERC and RCA tariffs into line, removing the tariff differential the State argued would be discriminatory. The FERC Trial Staff also supported a single tariff on TAPS.

(For citations and additional discussion see: Richard A. Fineberg, *Alaska Department of Law Imitates Wrong-Way Corrigan: Famous Aviator Left New York For L.A., Landed in Ireland – With increasing recognition focusing on Trans-Alaska Pipeline System (TAPS) shipping costs, does the peculiar history of TAPS tariff ratemaking hold lessons for the proposed natural gas pipeline?* [March 2, 2007 web site comment.])

[9] "Initial Post-Hearing Brief of the State of Alaska," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No. IS05-82-002, *etc.*), Feb. 16, 2007, p. 11.

[10] "Initial Decision," pp. 112-113. In her 277-paragraph decision, Judge Cintron dealt with the State's principal argument between paragraphs 258-263. In that section, she wrote:

> It has been found in this initial decision that the TAPS interstate rates for 2005 and 2006 are unjust and unreasonable. Thus, this decision contemplates new rate filings that will be substantially less than the Carriers 2005 and 2006 original filings. This new rate will be similar to the rates proposed by Anadarko/Tesoro. Anadarko/Tesoro's Opinion 154-B TOC interstate rate calculation for transport of a barrel from Pump Station No.1 to the Valdez Marine terminal is $2.04 for 2006 and $1.83 for 2006. Anadarko/Tesoro's calculations shown in Illustration Number 1 above were adopted in this decision. The State's Opinion 154-B reference rate in this proceeding for the interstate rates, for transport of one barrel from Pump Station No. 1 to the Valdez Marine Terminal is $1.96 and $2.05 for 2005 and 2006, respectively. The intrastate rate set by the RCA is $1.96 to transport a barrel of oil from Pump Station

Carriers file a single, uniform tariff annually, rejecting what I think most observers consider to be the State's second most important argument in this case.[11]

I am also troubled by apparent inconsistencies in some of the State's positions. Here are two examples:

➔The State appears to have reversed itself on one of the fundamental premises of the 1985 TAPS Settlement Agreement between the TAPS Owners and the State, represented by the Department of Law and its consultants. As recently as its 2004 Court appeal of the RCA's 2002 order reducing TAPS tariffs, the State was attempting to argue – in concert with the TAPS Owners – that the 1985 settlement can only be understood as a package established by trade-offs, individual tariff elements spelled out in the settlement and in annual tariff filings have no meaning.[12] But in its Initial Post-Hearing Brief in the CY 2005-2006 FERC tariff proceedings, the State testified that "[t]here can be no genuine debate over the fact that TSM [TAPS Settlement Methodology] depreciation is actual depreciation for ratemaking purposes."[13]

➔ In its initial post-hearing brief, the State, through the Department of Law and its consultants, argued that "the State has demonstrated that the reduced intrastate rate ordered by the RCA contributes at least its 'fair share' of earnings required to meet the maintenance and operating costs on TAPS and to yield a fair return on the property."[14] How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed for nearly two decades, and as recently as 2004? And How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed as recently as 2004 with its previous assertions to FERC that the much higher tariffs filed under the 1985 TAPS Settlement Agreement were both "cost-based" and "fair and reasonable"?[15]

While both reversals are welcome, their inconsistency with prior stated and vehemently argued positions suggests to me that State tariff argumentation may be driven more by tactical legal maneuvering than by firmly grounded policy considerations. Coming at this

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No.1 to the Valdez Marine Terminal. The difference between these rates and the RCA established intrastate rate are minimal. Accordingly, the discrimination has been alleviated and the State's discrimination claims are rendered moot. [Par. 263; citations omitted.]

[11] "Initial Decision," p. 110.

[12] State of Alaska, "Appeal of the Regulatory Commission of Alaska's Order No. P-97-4(151)," in Amerada Hess Pipeline Corporation, et al., vs. Regulatory Commission of Alaska (State of Alaska Superior Court Case No. 3AN-02-135112 CI), Mar. 1, 2004, p. 45. (Filed by Senior Assistant Attorney General Janice Gregg Levy , Robert H. Loeffler and Bradley S. Lui, Morrison & Foerster, LLP for Attorney General Gregg D. Renkes.) The State's 2004 appeal referenced the representations of the *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* at p. 33.

[13] "Initial Post-Hearing Brief of the State of Alaska," p. 24. (This passage summarizes similar arguments at pp. 3 and 18-23.)

[14] "Initial Post-Hearing Brief of the State of Alaska," p. 86.

[15] See, for example, State of Alaska and United States Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (submitted to Federal Energy Regulatory Commission with settlement offer in Docket No. OR 78-1, *etc*.), June 28, 1985, pp. 2, 89. (Filed by Attorney General Norman C. Gorsuch and Assistant Attorney General and Robert M. Maynard, State of Alaska, Robert H. Loeffler, Steven S. Rosenthal and W. Stephen Smith, Morrison & Foerster [State of Alaska] and Acting Assistant Attorney General [Antitrust Division] Charles F. Rule, Energy Section Chief Melanie Stewart Cutler and Special Litigation Counsel to the Assistant Attorney General [Antitrust Division] Donald A. Kaplan [U.S. Department of Justice.)

late date, I think it is important to ask how much money the State has lost and how much North Slope development has suffered due to the State's failure to understand and correct its long-held positions on tariff matters in a timely manner.[16]

In sum, a slew of important and long-delayed decisions and statements have borne out the long-held concerns of critics of the 1985 TAPS tariff settlement. Since 2002, a series of major legal decisions have fallen like dominoes against the TAPS Owners and against the positions the State argued vociferously until last year. But the fact remains: In the decade since Tesoro filed its first challenge to TAPS in-state tariffs, excessive TAPS tariffs have enabled the TAPS Owners to reduce their payments to the State by more than $1.1 billion (based on the RCA standard). And as careful examination of the FERC administrative law judge's decision demonstrates, the longer an excessive tariff is in place, the harder it becomes to collect full refunds.[17] In light of the fact (or apparent probability) that refunds will not fully attain that level, I believe the correct standard for State petroleum pipeline tariff policy analysis is to calculate what the State should have received if, instead of pressing its aggressive support of the TAPS Owners' position, the State had operated from its intent, clearly stated on the date of the 1985 settlement, to stand in the shoes of the Shippers.

In preparing for this hearing, I made a list of questions about State petroleum pipeline tariff policy that I wanted to see answered. Based on the difficulty this committee encountered obtaining information on the significance of the FERC Trial Staff's Feb. 16 brief in its March 5 hearing, I thought that a checklist covering background issues and recent developments in this complicated and important area might prove useful today. The twenty questions I came up with cover seven areas:

- Fiscal Impacts of TAPS Tariff Challenges on State Revenue;
- State Position in Current FERC Proceedings;
- Independent Producers and Shippers;
- Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement;
- TAPS Tariffs Under TSM v. *Explanatory Statement* Prognostications;
- Natural Gas Pipeline Tariffs; and
- Tariff Management Issues, including locus of responsibility for setting tariff policy and information about the Department of Law's consultants.

The intent of these questions is to help assess the current TAPS tariff situation, looking forward, and to discover what lessons the TAPS experiences holds for the proposed North Slope natural gas project. To the extent that many of these questions seek historical information, that is because TAPS tariff management issues demonstrate anew, in the Spring of 2007, the maxim of philosopher George Santayana that those who do not understand history are compelled to repeat it. If you find these questions worthy of your attention and you do not have substantive answers to them by the close of this hearing, I respectfully request that you forward them to the Attorney General for his consideration and written response.

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[16] During informal discussion, representatives of the Department of Law have told me that I am not giving the State's attorneys and their consultants sufficient credit for their efforts at FERC. One thing I hope to learn from the Department of Law today is exactly what the department believes it has accomplished in the FERC proceeding.

[17] See footnote 6, above.

I. Fiscal Impacts of TAPS Tariff Challenges on State Revenue

1. Fiscal Outcomes of Current Tariff Challenges. During the Mar. 5, 2007 State House Resources Committee hearing on TAPS tariff litigation at FERC, the Department of Revenue was unable to provide written information on its estimate of the fiscal impacts of the tariff case. The department provided a verbal estimate of potential gains to the State Treasure from a litigation victory for years 2005 through 2008 of $818 million. (Department of Revenue Tax Division Director Jon Iverson told the committee that its estimate was based on work that had just begun that morning; a one-page sheet containing that estimate was sent to legislators shortly after the hearing.) Recently, *Petroleum News* reported that the Department of Revenue now estimates the four-year sums at issue to be about $600 million.

- A. Please identify the factors that account for the change in the Department of Revenue's latest refund estimate.
- B. When did the Department of Law ask the Department of Revenue to quantify the impacts of the CY 2005 and CY 2006 tariff protests?
- C. When tariffs for CY 2008 will not be filed until December 2007, how was the CY 2008 estimate derived?
- D. When actual tariff data exists for CY 2005 through CY 2007 but future tariff data are not yet available, was it appropriate to include CY 2008 estimates with the three prior years?
- E. Did the Department of Revenue estimate revenue lost, based on the difference between the RCA tariff and the FERC tariff, for CY 2003 and CY 2004, or the full amount of the difference between a timely filing of a TOC tariff and the actual filed TSM?
- F. Why did estimates of future impacts terminate with CY 2008?

2. State CY 2004 TAPS Tariff Overcharge Protest at FERC. The State formally protested certain TAPS tariff charges in the CY 2004 tariff on Dec. 15, 2003. (This protest was not mentioned in the March 5, 2007 State House Resources Committee hearing.)

- A. Please indicate the status or disposition of each of those alleged TAPS tariff overcharges.
- B. Please indicate the estimated amount of the state revenue that was potentially at issue for 2004 and specify whether those amounts were included in the figures presented in response to Question 1, above.

3. State CY 2005 and CY 2006 TAPS Tariff Overcharge Protests at FERC. The State formally protested certain TAPS tariff charges in the CY 2005 and CY 2006 tariffs. (These protests were not discussed in the March 5, 2007 State House Resources Committee hearing.)

- A. Is the State still seeking recovery of revenue lost due to alleged CY 2005 and CY 2006 tariff overcharges by the TAPS Carriers?
- B. If not, how were the State's protests resolved?
- C. If so, please indicate the status of the challenge to each of those alleged TAPS tariff overcharges.

- D. Please indicate the estimated amount of the state revenue that was potentially at issue for 2005 and 2006 and specify whether those amounts were included the figures presented in response to Question 1, above.

4. Fiscal Outcomes of Tariff Protests Since 1996. It is conservatively estimated that since Tesoro first protested TAPS tariff overcharges in 1996, the State Treasury has lost at least $1.1 billion in reduced royalty and tax payments due to TAPS tariff overcharges. Yet, through most of that period, the State, represented by the Department of Law and its consultants, has sided with the TAPS Carriers against challenges to their tariffs. During this period, the State tariff protests filed at FERC by the Department of Law and its consultants sought tariff reductions on specific tariff elements that, in the Department of Law's view, were inconsistent with the 1985 settlement terms (rather than overcharges compared to the statutory standard of a "just and reasonable" tariff under AS 42.06 or comparable federal statutes). The FERC trial staff and ALJ decision confirm that protests under the latter grounds result in much larger refund payments to the State Treasury than protests the State filed.

- A. Please provide estimates of the annual amounts that might be obtained in refunds for tariff items the State has protested during this period as inconsistent with TSM terms.
- B. Please provide comparable estimates of the annual amounts that might have been obtained in refunds for tariff overcharges such as those alleged by Anadarko and Tesoro under the statutory standard of a "just and reasonable" tariff under AS 42.06 or comparable federal statute.

5. Tariffs below TAPS Settlement Agreement Ceiling. In November 1997, the State, led by the Department of Law and its consultants, entered into an agreement with the TAPS Carriers known as the "Capacity Settlement Agreement" (CSA). The CSA was designed to induce rate competition on TAPS, bringing about reduced tariffs over the next decade. According to the Attorney General, "[t]his settlement is historic because it assures competition among pipeline carriers to lower their rates." From testimony in the RCA rate case, it appears that as of 2001 the CSA agreement had resulted in very little rate reduction on TAPS. Moreover, in the decade since the settlement, the TAPS Carriers have increased tariffs significantly.

- A. For oil shipped under FERC tariffs since Jan. 1, 1998, please provide, by year, the average amount per-barrel by which the annual TAPS Settlement Agreement ceiling has exceeded actual TAPS tariffs under FERC jurisdiction.
- B. Have the Department of Law and/or its consultants analyzed the CSA to determine whether excess capacity naturally occurring on TAPS due to reduced throughput would have resulted in (a) the filed below-ceiling tariffs on TAPS and/or (b) additional tariff reductions?
- C. If so, can you provide those analyses?

II. State Position in Current FERC Proceedings

6. Tariff Levels. In the CY 2005-2006 FERC tariff proceedings, the State, through the Department of Law and its consultants, testified that "the State has demonstrated that the reduced intrastate rate ordered by the RCA contributes at least its 'fair share' of

earnings required to meet the maintenance and operating costs on TAPS and to yield a fair return on the property."[18]

- A. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed for nearly two decades, and as recently as 2004?
- B. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed as recently as 2004 with its previous assertions to FERC that the much higher tariffs filed under the 1985 TAPS Settlement Agreement were both "cost-based" and "fair and reasonable"?[19]

7. Depreciation. In its Initial Post-Hearing Brief in the CY 2005-2006 FERC tariff proceedings, the State, through the Department of Law and its consultants, testified that "[t]here can be no genuine debate over the fact that TSM depreciation is actual depreciation for ratemaking purposes."[20] But throughout But throughout RCA case and as recently as 2004, the State, through the Department of Law and its consultants, argued an apparently contradictory position. For example, in its March 1, 2004 opposition to the RCA decision that TAPS tariff filings were based on a clear statement of annual depreciation laid out in the 1985 settlement, the State argued that "the depreciation schedule in the TSM calculations does not represent a depreciation schedule for TAPS in any conventional sense" and warned that "a rule that a settlement depreciation schedule or any other depreciation schedule not approved for regulatory purposes constitutes 'actual depreciation' will lead to unreasonable results."[21] The 1985 Settlement Agreement's hyper-accelerated depreciation allowed the TAPS owners early recovery of their expenditures, enabling the TAPS owners to avoid paying refunds. But in 2001 the RCA found – as Tesoro had argued before the FERC – that the Carriers were seeking an unjustified double recovery of depreciation through tariff levels permitted under TSM.

- A. How did the Department of Law and its consultants arrive at the decision to reverse its long-held position that no element of the 1985 settlement can be viewed outside the context of the settlement because TSM is the product

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[18] "Initial Post-Hearing Brief of the State of Alaska," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No. IS05-82-002, *etc*.), Feb. 16, 2007, p. 86.

[19] See, for example, State of Alaska and United States Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (submitted to Federal Energy Regulatory Commission with settlement offer in Docket No. OR 78-1, *etc*.), June 28, 1985, pp. 2, 89. (Filed by Attorney General Norman C. Gorsuch and Assistant Attorney General and Robert M. Maynard, State of Alaska, Robert H. Loeffler, Steven S. Rosenthal and W. Stephen Smith, Morrison & Foerster [State of Alaska] and Acting Assistant Attorney General [Antitrust Division] Charles F. Rule, Energy Section Chief Melanie Stewart Cutler and Special Litigation Counsel to the Assistant Attorney General [Antitrust Division] Donald A. Kaplan [U.S. Department of Justice.)

[20] "Initial Post-Hearing Brief of the State of Alaska," p. 24. (This passage summarizes similar arguments at pp. 3 and 18-23.)

[21] State of Alaska, "Appeal of the Regulatory Commission of Alaska's Order No. P-97-4(151)," in Amerada Hess Pipeline Corporation, et al., vs. Regulatory Commission of Alaska (State of Alaska Superior Court Case No. 3AN-02-135112 CI), Mar. 1, 2004, p. 45. (Filed by Senior Assistant Attorney General Janice Gregg Levy , Robert H. Loeffler and Bradley S. Lui, Morrison & Foerster, LLP for Attorney General Gregg D. Renkes.) The State's 2004 appeal referenced the representations of the *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* at p. 33.

of a negotiated settlement involving many inter-related compromises and tradeoffs?[22]

- B. Could a better explanation for this switch in a long-held position have enhanced the State's credibility in this proceeding?
- C. Why did it take the Department of Law and its consultants 20 years to recognize that the Carriers' tariff filings under TSM were double-counting depreciation expenses to overcharge independent shippers?

8. Per-Barrel Allowance. Some observers believe that the 1985 TAPS Settlement Agreement departed significantly from principles of cost-based ratemaking by replacing the return profit calculation applied through 1989 with a per-barrel allowance (inflation-adjusted annually from a CY 1983 starting point of $0.35 per barrel). Under the 1985 agreement, beginning in 1990 the major profit element on TAPS was no longer related to the costs incorporated in the rate base.

- A. Have the Department of Law and its consultants compared the amounts the TAPS Carriers have gained through tariff collections realized through the inflation-adjusted per-barrel allowance in effect under TSM since 1990, plus other profit elements, to an allowable standard rate of return profits on a depreciated rate base under a standard cost-based ratemaking method?

9. May 17, 2007 FERC Administrative Law Judge Decision. The FERC Administrative Law Judge supported the A/T arguments, and recommended that the commission order reduced tariffs filed by the TAPS Carriers from over $5.00 per barrel to a level approaching the $1.96 per barrel tariffs ordered by the RCA in 2002 for in-state shipments, thus rendering moot the Department of Law's petition for a lower tariff on grounds of discrimination under the Interstate Commerce Act.

- A. Please identify the specific items in the ALJ decision in which the State believes it achieved significant victories.
- B. For each point on which the State believed it achieved significant gains, please provide a statement of the fiscal impact of each item and/or a brief summary of the policy implications of that item.

III. Independent Producers and Shippers

9. The State and Independent Producers/Shippers. According to the Explanatory Statement on the 1985 settlement agreement, because there is no other practical means to ship oil from the North Slope, "Alaska stands in the shoes of both past and future shippers . . . . Alaska's interests are coextensive with shippers."[23]

- A. How do the Department of Law and its consultants reconcile the State's prolonged opposition to independent shipper challenges to excessive TAPS tariffs with its assertions (e.g., in the Explanatory Statement accompanying

[22] State of Alaska and United States Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (Federal Energy Regulatory Commission, Docket No. OR 78-1, *etc*., pp.3-4 (quoted in State Brief, Mar. 1, 2004, pp. 32-33).

[23] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, p. 18.

the submission of the 1985 settlement agreement to FERC) that Alaska stands in the shoes of the shippers?

- B. Does the prolonged levy of excessive TAPS tariffs handicap independent producers, who must pay the excess tariffs out of pocket?
- C. Does the prolonged levy of excessive TAPS tariffs have a chilling effect on North Slope exploration and development by companies other than the TAPS owners?

10. Excess Tariff Handicaps to Independent Shippers. The FERC Administrative Law Judge concluded, citing A/T's numbers for CY 2006, that adoption of TOC (Trended Original Cost) methodology for TAPS would produce a tariff very near that of the RCA's DOC (Depreciated Original Cost) tariff. Using A/T's comparison of that rate to the TAPS Carriers' rejected proxy tariff, it appears that the major differences between the A/T TOC tariff of $2.04 per barrel and the TAPS Carriers' rejected TOC tariff of $5.53 per barrel are: Return Allowance ("return on equity)", Depreciation, Deferred Earnings and Income Tax Allowance. The first two items are associated, respectively, with Items 7. and 8., above; the third item represents payments to the Carriers for trending (inflation-adjusting) the rate base; the final item represents collections from shippers to pay the income tax on pre-tax net revenue. These four items represent charges in excess of a "fair and reasonable" or "just and reasonable" tariff, both of which allow the Carriers a reasonable return on their property.

- A. When a TAPS Owner ships its own oil, tariff charges in excess of actual costs represent internal transfer payments between the production and the transportation arms of the company. In contrast, the independent shipper must pay these costs out of pocket. Has the Department of Law asked its consultants or the Department of Revenue to quantify the handicap to independent shippers on TAPS of excess charges under the TAPS Settlement Methodology?
- B. If so, please provide that information on an aggregate and a per-barrel basis.
- C . Compared to TAPS tariffs filed under the 1985 settlement methodology , correction of these four specific tariff elements in the filed 2006 tariffs would reduce TAPS tariff revenue by approximately 60% (from more than $5.00 per barrel to approximately $2.00 per barrel). By comparison, if the State prevailed in its protest of specific elements of the 2006 tariff, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?
- D. For CY 2003, 2004 and 2005, following the A/T methodology please provide the amounts of corrections to the four specific tariff elements discussed in this question on an aggregate and per-barrel basis.
- E. By comparison, For CY 2003, 2004 and 2005, if the State were successful in its protest of specific tariff elements, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?

11. Antitrust Issues. In a 1996 interview, Conoco CEO Archie Dunham discussed Conoco's 1993 trade of its Milne Point field to BP for a Gulf of Mexico property and its departure from Alaska with *Hart's Oil & Gas Investor*. At the time of its departure from Alaska in 1993, Conoco was the only independent (non-TAPS owner) field operator on the North Slope. In the 1996 interview, Dunham commented: "It broke my heart to trade

Milne Point but we had to do it. All the value of that property was taken away from us in the pipeline tariffs."[24] In 1997 Maritime Endeavor, an independent tanker company, filed an antitrust suit against the TAPS Owners and Alyeska Pipeline Service Co. in federal court in Juneau, alleging that the TAPS owners were violating antitrust law by using technical requirements to prevent an independent tanker from serving the Alyeska terminal.[25] In October 1997, I prepared a report on TAPS antitrust issues for Oilwatch Alaska, in which I recommended that the Department of Law look into the issues raised in that report to ensure competition on the North Slope.[26] The Department of Law declined to undertake that investigation.

- A. When did the Department of Law become aware of Mr. Dunham's statement and what action did it take to determine whether there was a relationship between pipeline tariffs and the departure from Alaska of the only independent operator on the North Slope?
- B. When did the Department of Law become aware of the Maritime Endeavor case and what action did the Department of Law take to determine whether the company's complaint had merit?
- C. Are the Department of Law and its consultants aware of any other state or region producing more than 500,000 bpd in which (1) the only link to market is dependent on largely producer-owned transportation links whose average cost exceeds $4.00 per barrel and/or (2) three or fewer producers own more than 95% of the only pipeline link to market and control a similar share of production?

IV. Duty to Cooperate in Defending 1985 TAPS Settlement Agreement

12. Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement. It has been suggested that the State, represented by the Department of Law and its consultants, actively opposed the protests of Tesoro and other independent shippers at the RCA (and its predecessor, the APUC) for the first 7-1/2 years of this case – and is currently limited in its grounds for protesting TAPS tariffs at FERC – because Section 1-3 of the 1985 TAPS Settlement Agreement between the State and the Carriers requires that each party "cooperate . . . at its own expense . . . in defending against any litigation affecting the validity and enforceability of this Agreement, or any provision thereof." After opposing the independent shippers at the APUC/.RCA for approximately eight years, on Feb. 28, 2006. the State, represented by the Department of Law and its consultants, served notice that the State was withdrawing from case and would not be appearing before the State Supreme Court in the final argument on that case.

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[24] "Getting to the Future First" (interview by Leslie Haines), *Hart's Oil and Gas Investor*, August 1996, p. 39.

[25] This antitrust complaint (filed in U.S. District court, Juneau, by Maritime Endeavor Associates, LP against Alyeska Pipeline Service Company, Inc., and its owners [Case No. J97-010 CV {HRH}], May 27, 1997) was filed along with a companion breach of contract case filed in state court. The state case went first; in that case, the judge decided in favor of Maritime and awarded the plaintiffs a $10 million judgment (Judge Walter Carpineti, "Memorandum of Decision and Order," in Maritime Endeavor Associates, LP against Alyeska Pipeline Service Company [Case No. 1JU-95-1141 CI], Sept. 30, 1998). The decision was vacated and settled out of Court – reportedly for approximately $10 million. As part of the final settlement, Maritime dropped the federal antitrust charge.

[26] Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope* (Oilwatch Alaska, Oct. 23, 1997).

- A. Since the State evidently did not deem itself contractually bound to join the TAPS Carriers in actively defending the 1985 TAPS Settlement Agreement after Feb. 28, 2006, what factors prompted the State oppose the challenges of independent TAPS shippers at the RCA between 1996 and February 28, 2006, despite the fact that reduced tariffs would augment State revenue and promote competition on the North Slope by independent developers?

13. Definition of Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement. The 1985 agreement uses ten pages to describe the elements of the settlement methodology and contains an additional three page "Index of Defined Terms." Neither set of definitions makes reference to Sec. I-3 of the Settlement.

- A. Has the Department of Law attempted to determine the extent to which Sec. I-3 constrains the State's current challenges to TAPS tariffs?
- B. Has the Department of Law ever attempted to determine the legal extent to which Sec. I-3 of the 1985 settlement agreement constrained the State's challenges of possible or actual TAPS tariff overcharges between 1986 and the the present?
- C. If so, please (1) indicate the dates that written documents on this subject were prepared and (2) provide those documents.

V. TAPS Tariffs Under TSM v. *Explanatory Statement* Prognostications

14. Tariff Levels under TSM (1990-2011): According to the 1985 Explanatory Statement, tariff levels between 1990 and 2011 would be comparable to a DOC tariff and far lower than tariff implementing a TOC methodology.[27] However, (1) the RCA has determined that TSM permitted overcharges of nearly $10 billion through 1996, compared to a DOC tariff, and (2) the standard TOC tariff recommended b by the FERC ALJ would reduce current TAPS tariffs by more than 60%. The FERC Trial Staff and Administrative Law Judge agree that a properly implemented TOC tariff would produce current TAPS tariffs to levels very near that of a DOC tariff.

- A. What accounts for the radically differences between (a) the tariff outcomes calculated by the RCA and the FERC Trial Staff and Administrative Law Judge and (b) the prognostications of the 1985 *Explanatory Statement*?
- B. Please compare TAPS throughput from Jan. 1, 1986 through Dec. 31, 2006 to the forecast figures used in the Explanatory Statement prognostications?
- C. All other things being equal, in comparing actual results to 1985 projections, shouldn't increased production and reduced federal income tax rates have resulted in decreased tariffs, compared to 1985 projections?

15. Other Representations. In the 1985 Explanatory Statement, the Department of Law and its consultants asserted that "[t]he TAPS Settlement Agreement resolves all outstanding issues of dispute in regard to the settling carriers' TAPS tariffs." Moreover,

[27] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, pp. 88-89 and Appendices 7, 8.

the Explanatory Statement asserted, "[f]rom an administrative standpoint, the TSM will be practically as easy to administer as any other methodology."[28] In expressing the State's strong support for the maintaining the 1985 settlement at the start of the RCA hearing in April 2001, the State's consulting counsel told the RCA that the 1985 TAPS Settlement Agreement "has performed better than expected."

- A. In view of the facts that (a) tariffs under the 1985 settlement were significantly higher than a standard DOC tariff would have been and (b) the RCA, FERC Trial Staff and FERC Administrative Law Judge concur that actual tariffs filed in compliance with the settlement agreement have been excessive, what is the basis for the prognostications of the 1985 *Explanatory Statement* and the 2001 statements of the Department of Law's counsel, on behalf of the State, to the RCA?

16. Dismantling, Removal & Restoration (DR&R). This element of the 1985 TAPS Settlement, codified in Sec. II-4 and Exhibit E delivered a significant, off-book giveaway to the TAPS Carriers over and above the amounts indicated by the reckonings in Items 1 through 5 and 13, above. Although settlement presentations to the State Legislature (and the 1985 *Explanatory Statement*) misleadingly glossed over the gargantuan giveaway resulting from this settlement element, in 1986, the Alaska Public Utilities Commission Staff Expert Witness authoritatively explained that the accelerated over-collection and failure to escrow these sums would increase the off-book, after-tax gains to the TAPS owners by more than $7.0 billion.[29] A/T's current updating of that calculation indicates that the gains to the TAPS Owners will be more than twice that amount. Although more than 99 percent of those funds have already been collected from TAPS shippers through the accelerated terms in TAPS Settlement Exhibit E, the status and management of those funds is still at issue. In light of this background:

- A. What specific settlement benefits did the State receive from granting, through the 1985 settlement, DR&R collection terms to the TAPS owners that, according to the 1986 calculations of the APUC Staff Expert Witness, increased the estimated settlement gains to the TAPS Owners by more than 50 percent?
- B. In the two decades since this defect in the 1985 Settlement terms was identified and the resulting after-tax, off-book gains to the TAPS Owners were quantified, what steps did the Department of Law and its consultants take to remedy this situation?
- C. In 2000, the Department of Law became aware that a 1988 ruling by the U.S. Internal Revenue Service increased the tariff gains to TAPS Owners by making the DR&R pre-collections (which had been "grossed up" under the settlement terms to pay federal income tax) tax-deductible. At that time, the attorney representing the Department of Law promised the Legislature the attorneys and accountants would get to the bottom of this issue and remedy

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[28] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, pp. 17, 66.

[29] Prefiled Testimony of Rudolph L. Bertschi (Alaska Public Utilities Commission Docket No. P-86-2, Dec. 17, 1886), pp. 63-70 and Exhibits RLB-15, Schedules 1 and 2. (Reprinted in Appendix C of this writer's *Hidden Billions: The TAPS DR&R Provision* [report to Stan Stephens, August 21, 1992], pp. 47-57.)

it.[30] What substantive actions (if any) have the Department of Law and its consultants taken in the intervening six years to remedy this problem and what is the status of these efforts?

(VI.) Natural Gas Pipeline Tariffs

17. Sensitivity to Pipeline Tariffs. On a BTU equivalent basis, natural gas tariffs constitute a significantly greater percentage of the commodity price than oip pipeline tariffs. For example, Econ One places the gas tariff to Alberta (with conditioning plant costs) at approximately $1.50 per mmBTU.[31] By comparison, the average barrel of oil produces 5.8 mmBTU. Therefore, an oil tariff of $2.00 to $5.00 per barrel is transporting an equivalent commodity for somewhere between $0.34 to $0.90 per mmBTU, depending on the tariff. The figures above suggest that natural gas pipeline tariffs, as a percentage of the commodity price, would be somewhere between 66% and 340% greater than oil pipeline tariffs. It appears from this calculation, that both the viability of the project and State revenue are much more dependent on tariff decisions than the oil pipeline.

- A. Has the State prepared estimates of project tariffs for a proposed natural gas line? If so: (1) What is the range of the tariff estimate per mmBTU? (2) Does the variation in estimates reflect (a) differences in project costs, (b) uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology, or (c) both?
- B. Does the EconOne estimate of approximately $1.50 per mmBTU, plus or minus 20%, incorporate uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology?
- C. Does the State believe that natural gas trades at a discount to oil? If so, does that discount factor increase project sensitivity to tariffs?

18. Strategies to Reduce Sensitivity to Pipeline Tariffs. The history of the TAPS tariff implementation suggests that the State (a) rewarded bad behavior by the industry in1985 by caving in on cost over-runs, refunds and other major tariff issues when it entered into the TAPS Settlement Agreement and (b) after three decades of operation,has yet to secure just and reasonable tariffs on TAPS, to the detriment of State revenue and development.

- A. Have State tariff managers presented a strategy (with timelines for data submission and analysis, agency and court review procedures) that will ensure that just and reasonable gas pipeline tariffs are established in a timely manner?

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[30] See: Richard Fineberg, "New filings reveal oil pipeline owners' tax scam," *Anchorage Daily News* (Compass), Feb. 8, 2000, p. B-8; Richard A. Fineberg, "Federal Income Tax Payments on Dismantling Element of the Trans-Alaska Pipeline System (TAPS) Tariff" (corrected final testimony before the Alaska State House Oil & Gas Committee, April 13, 2000); and Letter from Attorney General Bruce M. Botelho (signed by Assistant Attorney General Michael A. Barnhill), May 23, 2000.

[31] Adapted from Anthony Finizza (consultant to Econ One), "Natural Gas Prices and Tariffs," presented to State Legislative Budget and Audit Committee, Aug. 31, 2005, pp. 16-17. (2005 estimates adjusted to reflect inflation and current prices; Dr. Finizza estimated that this tariff estimate could be 20% high or low.)

- B. On May 12, 2006, a Department of Law consultant representing the Administration assured legislators that, at least in theory, producers could be expected to contain pipeline costs to a greater extent than independent pipeline builders because, as shippers, they would have to pay the tariff. (1) Has the Department of Law explained the apparent contradiction between the historical reality of TAPS tariff charges and his statement?

(VII.) Pipeline Tariff Management Issues

19. Payments to Department of Law Consultants. Between 1981 and June 30,1997, the Department of Law paid Morrison & Foerster and its associates more than $20 million for legal assistance associated with TAPS tariffs. During the 1980s, payments averaged approximately $1.0 million per year, increasing to about $1.5 million per year during the 1990-93 period and $2.1 million per year between Jan. 1, 1994 and June 30, 1997.[32]

- A.. Does this amount include payments to accountants working with Morrison & Foerster, including Dr. Thomas Horst?
- B. How much did the State of Alaska pay Morrison & Foerster and its associates, including Dr. Thomas Horst, for work on TAPS tariff issues between July 1, 1997 and June 30, 2003?

According to the *Alaska Budget Report*, between July 2003 and the end of 2006 the State paid the law firm of Morrison & Foerster $12,268,896 million for legal services and negotiations.

- C. Does the $12.3 million payments to Morrison & Foerster between July 2003 and the end of 2006 include payments for work on TAPS, including payments to Dr. Thomas Horst, for work on TAPS tariff issues?
- D. Between July 2003 and the end of 2006, how much did the State of Alaska pay Morrison & Foerster and its associate accountants, including Dr. Thomas Horst, for work on TAPS tariff issues?

20. Responsibility for State Pipeline Tariff Policy. The Alaska Pipeline Act lists ten general powers and duties of the RCA under which that agency regulates pipelines and pipeline carriers in the state. The final subsection states that the commission

> (10) shall provide all reasonable assistance to the Department of Law in intervening in, offering evidence in, and participating in proceedings involving a pipeline carrier or affiliated interest and affecting the interests of the state, before an officer, department, board, commission, or court of another state or the United States.[33]

[32] Alaska Dept. of Law, "Oil & Gas Contract Summary, 1977-February 15, 1994" [attachment to letter from Attorney General Bruce Botelho to House Finance Committee Co-Chair Ron Larson, Feb. 17, 1994], supplemented by personal communication from Alaska Department of Law, August 1997.

[33] AS 42.06.140(a)(10).

- A. Apart from this statutory reference to the Department of Law, please identify any statutes that specifically assign responsibility for pipeline tariff policy to the Department of Law.
- B. The various sections of the Civil Division of the Department of Law handle legal matters and provide legal advice to the agencies of the executive branch. What state agency has statutory authority to set and review pipeline tariff policies?
- C. Please identify any functions of State government for which the Civil Division of the Department of Law not only handles legal matters associated with implementing policy, but also has (1) statutory and/or (2) *de facto* responsibility for setting and reviewing that policy.

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Again I want to thank you for your efforts in this important area.