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Fineberg says state needs information

Independent researcher says getting it wrong on gas tariff could cost state billions; preparation needs to start now for FERC

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Three decades of operation of the trans-Alaska oil pipeline demonstrate that the State of Alaska can't afford to get the tariff on a gas pipeline wrong, Richard Fineberg told legislators July 25. Fineberg said he reported on the building of the oil pipeline and has been involved for years in tariff issues on that line. The state stands to lose billions in revenue on a too-high tariff for shipping natural gas, he said, and North Slope competition would again be inhibited, jeopardizing future development.

Fineberg testified before the Alaska Senate Special Committee on Energy on a report he wrote for the Alaska Public Interest Research Group about questions he believes aren't addressed in the state's findings on AGIA. Natural gas contracts and tariff issues are complicated, and in spite of the time legislators have put in on the TransCanada Alaska application under the Alaska Gasline Inducement Act, the level of complication and the details issues turn on are "orders of magnitude more complicated" than what legislators have gotten to yet, he said.

Fineberg said information will be critical in dealing with tariff issues on a gas pipeline. AGIA, in spite of the time, dedication and intent of those who crafted it, lacks essential safeguards to ensure that the Federal Energy Regulatory Commission will deliver low tariffs, he said.

A critical component is "guaranteed access to all the critical information in a timely manner," Fineberg said, including information needed "to ensure state revenues and the maintenance of open competition that hinge on the attainment of lowest reasonable tariffs."

Fineberg said FERC regulators have had little occasion to deal with tariff issues on producer-owned gas pipelines and the AGIA proposal "lacks systematic safeguards to protect against the possibility that unscrupulous parties might use various accounting devices to artificially elevate reported costs and filed tariffs, thereby overcharging shippers and reducing state revenue."

Recourse tariff a ceiling

Fineberg said he believes the tariff process opens "with a bad beginning," the recourse or ceiling tariff — the highest rate that can be charged. This is not the low tariff; it's the ceiling, he said.

When it sets tariffs for natural gas pipelines, Fineberg said in his report, FERC starts out with preliminary cost estimates and a projected tariff, the recourse tariff. That rate is proposed by the shipper as part of its FERC application and "effectively sets a ceiling for further tariff negotiations between the pipeline company and prospective shippers," he said.

Then there is the negotiated tariff, a rate negotiated between the pipeline and shippers. Because the shippers are the producers, the experience with the trans-Alaska oil pipeline is that shippers don't reduce tariffs, they go for high tariffs, Fineberg told legislators. And as a rule, there are no refunds on negotiated tariffs because the shippers are supposed to negotiate the recourse rate down.

Asked by Sen. Bill Wielechowski, D-Anchorage, if he's found higher tariffs for independent pipelines or producer pipelines, Fineberg said he hasn't done that research, but he said Barry Pulliam (of Econ One) presented such data in the administration's AGIA presentations in June. That data showed a 19 percent average reduction from the recourse rate to the negotiated rate on independent pipelines, Fineberg said. On Alliance Pipeline, developed by producers who have since sold their interest, Pulliam's data showed no reduction from the recourse to the negotiated tariff.

Fineberg said he looked at the Alliance rates and found the negotiated tariff had increased over the recourse rate because of cost overruns.

So there is evidence of reduction between the recourse rate and negotiated rates on independent lines, Fineberg said, but only limited evidence for producer-owned lines. There are very few examples of such lines because for many years the U.S. banned producer-owned lines and so there aren't many of them; Alliance is a good example because it was a large project, costing $5 billion, he said.

Remedies — information

As for remedies, Fineberg said the state needs access to "timely and complete information," which it doesn't have now.

If AGIA is set in motion, the state needs to begin immediately preparing to work on costs to be sure the recourse tariff doesn't set the bar too high, he said. Ongoing accounting and oversight will also be necessary: After the 2006 Petroleum Profits Tax was passed it became clear the state didn't have the accounting mechanisms and that had to be fixed in ACES, Alaska's Clear and Equitable Share, the legislation passed in 2007 under the Palin administration, he said.

Fineberg said accounting and oversight are needed for both in-state issues and for issues that will arise before FERC.

There are gray areas where producers and shippers will have an interest in maximizing their revenue; and the producers may not negotiate the pipeline down on the tariff, he said. One area that hasn't been discussed is inappropriate gaming, especially on issues where the interests of the majors differ from those of independent shippers, Fineberg said.

Committee Chair Charlie Huggins, R-Wasilla, and Sen. Tom Wagoner, R-Kenai, asked if producer ownership in a line wouldn't mean that the producers would work to get a lower tariff.

Fineberg said it would take real numbers, and incredibly complicated modeling, to determine at what point the producers' interest in a low tariff vanishes.

Interests turn on "very subtle things," he said, and one of them is whether the income tax effect is correctly understood. Fineberg said there are tax benefits that could conceivably change the answer and said he believes that if the state spent the time to work through all of the numbers there would be surprises and lawmakers wouldn't be quite so comfortable because there are variables the state cannot control, and one of them is taxes.

Steve Porter, a consultant for the Legislative Budget and Audit Committee, said FERC will go for a reasonable tariff and AGIA set parameters on a tariff, but the only party that can protect the interests of the state is the state. Porter agreed with Fineberg's recommendation that the state participate in tariff hearings before FERC and the National Energy Board of Canada.

Asked by Sen. Kim Elton, D-Juneau, whether it would require a change in AGIA for the state to participate in tariff hearings, Porter said the state has the right to represent itself before FERC or NEB for the TransCanada Alaska pipeline and for the Denali pipeline.

Huggins asked about some of the cost estimates Fineberg cited for the TransCanada Alaska project and Fineberg cited work Goldman Sachs did for the administration with a median $46 billion cost.

Fineberg said that with penalties for cost overruns built into its proposal, the state should expect TransCanada to highball every cost it legally can so it can get a higher rate of return by avoiding the penalty. He also said he is concerned that the state wants to tie up the federal loan guarantees to cover possible cost overruns when those guarantees could be used upfront to cut the cost. He said it appeared the state has traded off the gain of loan guarantees and has given its share to the pipeline company.

Additional questions

At the request of Huggins Fineberg put some fundamental questions about gas pipeline tariffs to the committee in a July 26 follow-up letter.

He said the average litigated natural gas rate case at FERC is roughly 50 months, with a 36-month average for a contested settlement. He asked what the average time was for such cases by project size ranging from greater than $20 billion to greater than $1 billion.

Fineberg asked about the likelihood that FERC can assure just and reasonable rates without competition from other pipelines to test the rates and rate structure and whether FERC or the TransCanada Alaska AGIA proposal "contain substantive language to ensure that the veil of confidentiality imposed at the nuts-and-bolts level of this arcane process will not prevent parties with an interest in inflating their tariff numbers from disclosing the information that would enable those harmed by the particular transaction from obtaining, in a timely manner, the information they would need to identify the problem, assess its significance, understand its mechanics and respond to protect their interests?"

'Eerie similarity'

Fineberg said he sees an "eerie similarity" between where the state is with the AGIA TransCanada Alaska gas pipeline proposal and where the state was in 1985 when it reached a settlement on the oil pipeline tariff, a settlement since overturned by both the Regulatory Commission of Alaska and FERC on grounds that the rates established were not just and reasonable.

That cost the state billions, he reminded the committee.

On the other hand, in his 27-page report for AkPIRG, dated July 22, Fineberg said he has watched "with growing admiration" as the state's citizen legislators, over the last two years, "buckled down to the gritty, painstaking tasks of learning as much as they could about complicated issues before punching the red or green button."

And over those same two years, "I have been delighted to see administration personnel break old habits of interdepartmental skirmishing and indifference to the public to work together as a welded team intent on conducting genuine public outreach."

But the similarities to 1985 remain, he said: "Once again, the enormity and complexity of the terrain make it difficult to figure out where the arcane mechanics of tariff formulation and implementation fit into that landscape."

Ad hoc oversight group

AGIA does not prevent the state from challenging a tariff proposed by TransCanada Alaska, but Fineberg said Commissioner of Revenue Pat Galvin has acknowledged the state would carefully consider the interests of its partner before advocating a reduction.

The state signed off on the 1985 settlement on the trans-Alaska oil pipeline tariff, including a "duty to defend" clause negotiated by the Department of Law, which "effectively handcuffed the state on tariff issues for more than two decades," Fineberg said in his report. He went on to say that the state cannot afford such restrictions on a

natural gas pipeline, “where the FERC regulatory regime appears to offer fewer remedies and greater incentives for high pipeline tariffs.”

“Instead of focusing on tariff mechanics and implementation, the administration is content to kick that can down the road with the observation that nothing in the AGIA contract worsens the existing situation,” Fineberg said.

Fineberg said in his report that he does not believe the state can rely on FERC to ensure low tariffs, and recommends that the state “establish an ad hoc oversight group to ensure that the state maintains a pro-active posture in its efforts to assure low pipeline tariffs on the AGIA pipeline.”

TransCanada speaks of its experience in opening basins, he noted, but an “industry veteran says the industry strives for basin control.” Fineberg said that given the history of the trans-Alaska oil pipeline, “it would be a mistake to assume the former approach to basin development is operable but the latter is not.”

Why the concern

Fineberg said in his report that access to confidential data has shaped his views.

“At the end of the day, I believe it is the recognition of the importance of withheld confidential information — to which I have had access in various cases over the past three decades while working with various state and federal agencies on tax, royalty and ratemaking issues — that may explain why I have parted company from others engaged in this process whom I greatly respect.”

Based on that experience, he said he believes the state needs “full and timely access” to information in order to protect its own interests and those of independent developers.

“In my experience, pipelines (due to geographic realities) and bureaucracies (due to the multiple responsibilities of the players) are both inherently vulnerable to information short circuits,” he said in his July 26 letter to the committee. “For this reason, I am particularly worried about information constraints when the largest pipeline project ever undertaken on this continent will span 1,715 miles much of which is in another country with different tax, regulatory and oversight frameworks. Without affirmative, advanced resolution of this issue, the state will remain vulnerable to the consequences of tariff gaming.”

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