

How TAPS Tariffs Affect State, Federal and Industry Income Derived from North Slope Crude Oil

Implications for Public Policy and Suggestions for Problem Resolution

**Prepared for Meeting with Interior Legislative Delegation
3:00 p.m., August 20, 2007**

**Richard A. Fineberg, Principal Investigator
Research Associates
P.O. Box 416
Ester, Alaska 99725**

Disclaimer

I am speaking today as a private citizen. The views expressed here are solely my own and should not be construed as those of any other party.

I am about to begin an engagement with the Alaska Department of Revenue (ADOR) to review the implementation and effects of the Petroleum Profits Tax. Under these unusual circumstances, I want to make it clear that this afternoon's informal meeting was set up by legislators before the Special Session was scheduled and before I had any indication that ADOR would be retaining my services as a consultant. I have yet to attend my first meeting with ADOR and its other consultants and have not yet received any substantive data from ADOR (or anybody else in the Administration).

Documentation and background information on pipeline tariff issues can be found at my web site (<http://www.finebergresearch.com>).

– Richard A. Fineberg
P.O. Box 4416
Ester, AK 99725

Tel (907) 479-7778
Email: Fineberg@alaska.net

(Minor edits and annotation added, Aug. 30, 2007.)

Are TAPS Tariffs Excessive?

Culminating a proceeding that began in 1997, in 2002 the Regulatory Commission (RCA) of Alaska determined that

- **TAPS tariffs exceeded the statutory "just and reasonable" standard prescribed by AS 42.06 by more than \$9.9 billion between 1977 and 1996.**
- **Then-current tariffs (averaging approximately \$3.05 per barrel) were approximately 57% higher than the amount necessary to enable the TAPS Owners to cover all costs and earn a reasonable return on their investment.¹**

Since then, the TAPS Owners have steadily increased tariffs filed under the 1985 TAPS Settlement Methodology (TSM) and still applicable at the Federal Energy Regulatory Commission (FERC), which regulates TAPS shipments bound for destinations outside Alaska (approximately 89% of TAPS volume), to approximately \$5.11 per barrel.²

Also since 2002:

- **In 2003, the RCA implemented its order, reducing tariffs on the 11% of TAPS oil under its jurisdiction to \$1.96 per barrel.³**
- **In 2004, the TAPS Owners and the State (represented by the Department of Law), went to court to oppose the RCA's order.⁴**
- **In January 2006, Superior Court Judge John Suddock upheld the RCA decision "in all respects."⁵**
- **In February 2007, the FERC Trial Staff endorsed the RCA decision.⁶**
- **In May 2007, the FERC Administrative Law Judge (ALJ) presiding over a similar TAPS tariff protest against rapidly escalating FERC tariffs under TSM brought by independent producer Anadarko and independent shipper Tesoro adopted the independent shippers' numbers and recommended that the current tariff of more than \$5.00 per barrel should be reduced to approximately \$2.04 per barrel.⁷**

- **As they did in the 1970's and early 1980's, the TAPS Owners "stonewalled . . . (the State) and you gave in They used the power of the corporate treasure, of the courts, to absolute stonewall anything that happened." ⁸**
 - *U.S. Rep. Norman Sisisky [D. - Va.] to the Alaska Dept. of Law at a hearing in Washington June 18, 1985 on the pending adoption of the TSM.*
- **Decisions are expected in the next six months in the RCA case (argued before the Alaska Supreme Court in March 2007) and also in the FERC case.**

The House Resources Committee held hearings on TAPS tariff issues March 5 and again June 7. While these meetings went a long way toward developing understanding of TAPS tariff and tariff management issues, in my estimation the Department of Law has not been fully responsive to the committee's oversight efforts.⁹

Why Do Excessive Tariffs Matter?

- **During the three decades of TAPS operation, the difference between the tariff allowed under TSM and the RCA's "just and reasonable" tariff level has cost the State at least \$4.5 billion.¹⁰**
- **While the TAPS owners pursue their right to litigate, the State is losing approximately \$400 per minute. (The Department of Law, which says its actions are circumscribed by the terms of its agreement to the 1985 settlement with the TAPS Owners, hopes to recoup a portion of the current loss through refunds.)¹¹**
- **The North Slope holds approximately 35 TCF of natural gas reserves, with 51 TCF needed for optimum economics on the long-delayed natural gas line. The State counts on independent developers to explore and discover additional economic deposits on the North Slope. But the State's acquiescence and failure to curb excessive tariffs on TAPS threatens the ability of independent producers to establish an economically viable foothold on the North Slope.**

It is important to remember:

- **Three companies produce more than 95% of North Slope crude oil; the same three companies own more than 95% of TAPS. This is a unique situation with unique implications.**

Consider the cash flows:

- **Under PPT at \$60.00 per barrel prices, I estimate that the TAPS Owners gain more than \$2.00 per barrel on the tariff they charge independent producers (such as Anadarko), while the independent shippers lose more than \$1.00 per barrel (net) on the excess charges they pay.¹²**
- **Put otherwise: When oil prices drop, the independent shipper will hit a "stress price" under TSM at a market price more than \$3.00 per barrel higher than the TAPS owners. (No wonder why independent shippers have challenged the TSM tariff at FERC.)**

How Did We Get Into This Predicament?

- **When it submitted the 1985 TAPS settlement agreement to FERC for approval in 1985, the State assured the regulators that "Alaska stands in the shoes of both past and future shippers Alaska's interests are coextensive with shippers."¹³**
- **But for more than two decades, the state has left independent shippers to fend for themselves. And between 1996 and 2006, the State actively opposed the interests of independent shippers on TAPS. One reason for this policy reversal is a clause in the settlement agreement that limits the State's ability to support shipper interests by requiring the State to "cooperate . . . in defending against any litigation affecting the validity and enforceability of this Agreement, or any provision thereof."¹⁴**
- **Did this clause truly tie the State's hands? Perhaps not. The State did not appear with the Owners before the State Supreme Court in March 2007.¹⁵ (This fact confirms that the State's duty to cooperate in defending the 1985 settlement has limits.)**

Who Makes State Tariff Policy?

Distinct from almost every other area of public policy, no line agency (such as ADOR or ADNR) has express statutory authority for dealing with interstate tariffs. In the absence of statutorily defined responsibilities, the Department of Law manages interstate tariff matters.

- **Historically, the Department of Law's changing cadre of young attorneys assigned to tariff matters appear to have been strongly influenced by the consulting firm that assisted in executing the 1985 settlement and has been the leading consulting firm on pipeline tariffs since that time. (That firm also played a leading role in the 1999-2000 ARCO-BP merger deliberations and the 2006 Stranded Gas Act proposal by the former governor.)¹⁶**
- **The regulatory manager of one major domestic firm says that his company struggled for years to wrest tariff policy management from its lawyers; he says his firm believes policy should drive the legal maneuvering of its tariff team. (At that company, the ratio of tariff staff to lawyers is approximately 5 to 1.)¹⁷**

What Is To Be Done?

- In establishing the responsibilities of the RCA, the Alaska Pipeline Act (AS 42.06) lists ten general powers and duties under which that agency regulates pipelines and pipeline carriers in the state. The final subsection (AS 42.06.140[a][10]) 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.
- Changing the word "Law" in the second line of AS 42.06.140(a)(10) to "Natural Resources" (or "Revenue") would vest a line agency with authority and responsibility to manage tariff policy.

Why Can't We Wait?

While it is tempting to wait for the courts and the FERC to render final decisions, the history of Alaska tariff management indicates that without a change in **tariff management structure**, the TAPS Owners can be expected to continue to prevail in the use of dilatory tactics to prolong their lucrative arrangements, to the detriment of the State Treasury and the proposed gas line. Consider:

- **Between 1997 and 2006, against its own best interests, the State, represented by the Department of Law, fought the independent shippers at the RCA and then, in 2004, went to court to oppose the RCA decision. The stated rationale was the “duty to defend” clause of the 1985 settlement. But if this putative obligation really locked us in, how is it that in 2006 the State simply withdrew its support from the TAPS Owners’ protest at the Supreme Court?**
- **Does anyone have a clue as to why the State gave up TAPS refund claims for 2004 when we were holding a blockbuster RCA decision ordering huge tariff reductions?¹⁸ (Has anybody asked?)**

- **The Dept. of Law's 1997 Capacity Settlement Agreement was supposed to induce competition on TAPS; it didn't.¹⁹ Did officials ever conduct a follow-up check on the results of this agreement? I don't think so. One reason may be that no agency had responsibility to do so.**
- **Remember when Conoco, the only independent operator on the North Slope, left Alaska in 1993? In 1996, Conoco President and CEO Archie Dunham said: "It broke my heart to trade Milne Point, but we had to do it. All of the value of that property was taken away from us in the pipeline tariffs."²⁰ The next year, an independent tanker company filed an antitrust suit against Alyeska, alleging that the TAPS owners were keeping the independent tanker out of Valdez. (At the time, that tanker would have been the only independent tanker in the TAPS trade and its owners maintained they would have induced competition resulting in reduced shipping rates.)²¹ In late 1997 the Department of Law declined to investigate alleged antitrust problems.²²**

These are just a few of the cases that confirm the need to make a line resource agency responsible for this important resource policy issue.

Conclusion

Speaking as an independent citizen (this meeting was arranged before I had any idea that the Department of Revenue might retain my consulting services to assisting in reviewing the PPT), I believe that substantive answers to the questions I posed in my written testimony to the House Resources Committee June 7²³ would go a long way toward confirming the documentary record that supports the recommendation that tariff policy management should be assigned to a line agency. (Those questions and the Department of Law's partial answers can be found on my web site.)

At this time, the Department of Law is to be commended for working cooperatively with line agencies. But the fact remains:

- History demonstrates that petroleum pipeline tariff management is a headless horseman. If North Slope petroleum development is to continue to flourish, this horse must be harnessed to public policy.**

Thank you for the opportunity to share this information with you.

Slide 14

Notes:

¹ 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](#), Nov. 27, 2002, pp. 1-9. See also: RCA, "The Regulatory Commission of Alaska Rejects Rates for the 1997-2000 Intrastate Trans-Alaska Pipeline System, Sets Just and Reasonable Rates, and Requires Refunds and Filings by Carriers," Nov. 27, 2002 (press release).

² For estimated weighted annual TAPS tariffs between 1997 and 2007, 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](#), Alaska Budget Report, Feb. 28, 2007, p. 4.

³ See: Regulatory Commission of Alaska, *Order Rejecting the TAPS Carriers' 2001-2003 TSM Intrastate Filings, Rejecting the TAPS Carriers' Post-2000 Revenue Requirement and Rate Filings, Establishing Permanent Post-2000 Intrastate TAPS Rates, Requiring Refunds, Ordering Release of Escrowed Funds, Letters of Credit, and Bonds; Approving Filings and Affirming Electronic Rulings*, June 10, 2004 [Redacted]).

⁴ State of Alaska, *Appeal of the Regulatory Commission of Alaska's Order No. P-97-4(151)* (Case No. 3AN-02-13511 CI), Mar. 1, 2004.

⁵ John Suddock (Superior Court Judge), [Decision and Order, Amerada Hess Pipeline Corp., et al. v. Regulatory Commission of Alaska](#), Jan. 18, 2006, p. 76 (Case No. 3AN-02-13511 CI).

⁶ Dennis H. Melvin (Director, Legal Division) and Marcia A. Lurensky (Commission Staff Counsel), *Initial Brief of the Commission Trial Staff*, Feb. 16, 2007 (Anadarko Petroleum Corporation v. TAPS Carriers, FERC Docket Nos. OR05-3-001 and OR06-2-000, etc.).

⁷ Carmen A. Cintron (Presiding Administrative Law Judge), *Initial Decision*, Federal Energy Regulatory Commission, May 17, 2007 (FERC Docket Nos. OR05-3-001 and OR06-2-000, etc.).

⁸ U.S. House of Representatives, Committee on Small Business, Subcommittee on General Oversight and the Economy, *H.R. 245 and Trans-Alaskan Pipeline System Tariffs*, June 18, 1985, pp. 157-158.

⁹ See: Richard A. Fineberg, ["State House Resources Committee Finds More to TAPS Ratemaking Issues than Meets the Eye"](#), March 10, 2007 (analysis and comment on March 5, 2007 tariff hearing).

¹⁰ For rough estimates of state revenue losses due to excessive TAPS tariffs since North Slope oil began flowing in 1977, see [Difference Between RCA's 2002 TAPS Tariff Order and State's 1985 Pipeline Tariff Agreement Costs State More Than \\$400 per Minute](#) (estimate in real [2007] dollars).

¹¹ *Ibid.*

¹² For estimating methodology, see: Richard A. Fineberg, [What You Don't Know Can Hurt You: The Need for Further Public Deliberations on Alaska North Slope Petroleum Fiscal Regime Overhaul](#) (Alaska Public Interest Research Group), May 10, 2006, Worksheet 2.

¹³ 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*, June 28, 1985, p. 18 (submitted to the Federal Energy Regulatory Commission with TAPS settlement offer, Docket No. OR 78-1, etc.; quoted in State Superior Court brief, Mar. 1, 2004, pp. 32-33).

Notes (Continued):

¹⁴ State of Alaska and TAPS Carriers, *Settlement Agreement between the State of Alaska and ARCO Pipe Line Company [et al.] with respect to the Trans Alaska Pipeline System*, June 28, 1985, Sec. I-3. (Note: The bold-faced headers are included in the settlement for convenience only and are not part of the settlement agreement.)

¹⁵ State of Alaska, *Notice of Non-Participation*, Feb. 24, 2006 (Alaska Supreme Court Case No. S-12230; Superior Court No. 3AN-02-13511 CI).

¹⁶ See: Richard A. Fineberg, ["Twenty Questions on Trans-Alaska Pipeline System Tariffs And State Pipeline Tariff Management Issues,"](#) June 7, 2007 (testimony before the Alaska State House of Representatives), p. 14; and Phillip A. Reeves (Senior Assistant Attorney General, Alaska Department of Law), ["Dear Representatives Gatto and Guttenberg,"](#) June 28, 2007, pp. 5-6.

¹⁷ Personal communication.

¹⁸ See: Alaska Department of Law, "State and TAPS Owners Enter MOU," Jan. 24, 2004 (News Release); and "State Protests 2005 Trans-Alaska Pipeline Oil Transportation Tariffs: Attorney General Says Rates Are Too High," Dec. 15, 2004 (News Release).

¹⁹ State of Alaska and TAPS Carriers, "Offer of Settlement," Oct. 31, 1997 (Exxon Pipeline Col., *et al.*; FERC Docket No. OR-96-1-000, *et al.*). For typical press coverage of the Capacity Settlement Agreement, see Rose Ragsdale, "Pipeline settlement ensures competition to reduce carrier tariffs," *Alaska Journal of Commerce*, Nov. 10, 1997, p. 3. My conclusion is based on tariff data reviewed in 2001 and the 1997-2007 TAPS tariff profile (see footnote 2).

²⁰ "Getting to the Future First," *Hart's Oil and Gas Investor*, August 1996, p. 41 (interview with Conoco President and CEO Archie Dunham). See also: Richard A. Fineberg, ["The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope,"](#) October 1997 (Oilwatch Alaska).

²¹ *Maritime Endeavor Associates, L.P. (Plaintiff) v. Alyeska Pipeline Service Co., Inc., et al., "Complaint (Clayton and Sherman Antitrust Acts, 15 U.S.C. Secs. 1 and 2, 15 U.S.C. Sec. 15),"* May 27, 1997 (U.S. District Court, Juneau, Alaska, Case No. J97-010 CV [HRH]). Two years earlier, Maritime Endeavor filed a companion case, based on the same set of alleged facts, in Alaska Superior Court. The independent tanker company prevailed in the state case 1998, when the judge awarded the plaintiffs \$10,025,362.75 after a three-week trial. The decision was subsequently vacated after an out-of-court settlement and the companion federal antitrust case was dismissed with prejudice. (Walter L. Carpeneti [Superior Court Judge], *Memorandum of Decision and Order, Maritime Endeavor Associates, L.P., v. Alyeska Pipeline Service Co.*, Sept. 30, 1998; and *Stipulation and Order for: Vacation of September 30, 1998 Memorandum of Decision and Order and Dismissal of Action with Prejudice*, Feb. 17, 1999 [Case No. 1JU-95-1141 CI].)

²² See: Letter from Bruce Botelho (Alaska Attorney General) to Jim Sykes (Director, Oil Watch Alaska), "Re: *The Big Squeeze*," Nov. 7, 1997; and Brian O'Donoghue, "Suits allege antitrust violations by Alyeska," *Fairbanks Daily News-Miner*, Nov. 30, 1997, p. A-1.

²³ ["Twenty Questions on Trans-Alaska Pipeline System Tariffs And State Pipeline Tariff Management Issues,"](#)