

TAPS Tariffs – Five Columns by Staff Writer Dermot Cole **. from the *Fairbanks Daily News-Miner*, April. 29 - July 7, 2007)**

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Attorney general's office needs to be more forthcoming on oil tariff history

By Dermot Cole

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TARIFF CASE: In a game of 20 questions about trans-Alaska pipeline tariffs, the state attorney general's office should keep playing.

Fairbanks oil analyst Richard Fineberg, who has followed the tariff controversy more closely and for longer than anyone other than certain industry and government attorneys, posed 20 pertinent questions about the state's handling of tariff matters.

Reps. Carl Gatto and David Guttenberg submitted those to the Palin administration last month, but Senior Assistant Attorney General Philip Reeves declined to answer many of them in a June 28 letter.

This should be unacceptable to legislators seeking a basic understanding of the legal and regulatory morass concerning the price of shipping oil through the pipeline.

One of the most important unanswered questions on Fineberg's list is why the state has taken contradictory positions on tariffs over the years.

Fineberg asks how the state reconciles its current support for lower tariff levels with its opposition to them as recently as 2004.

He said "for nearly eight years the Department of Law steadfastly opposed the state's immediate fiscal interests" by actively fighting attempts by Tesoro and Anadarko to get lower tariffs before the Regulatory Commission of Alaska.

The RCA concluded in 2002 that the oil companies were charging excessive tariffs. The state challenged the RCA ruling and claimed the agency "abused its discretion," but a Superior Court judge held for the RCA.

This all goes back to a pipeline tariff settlement in 1985, but the debate continues to this day about what the state's responsibilities are under that deal.

Alaskans deserve responses from the Palin administration on these matters, even if the answers raise doubts about previous administrations and the advice from consultants who have been paid millions over the years.

Reeves told the legislators that the administration is not inclined to talk about the past: "We respectfully decline to participate in Mr. Fineberg's effort to challenge the legal decisions and strategies of past state litigation efforts under past attorneys general and will limit our response to questions involving the current litigation."

But knowledge of the past is crucial if we are to understand the present. That is certainly true in the convoluted world of oil tariffs.

The tariff, which is the cost of transporting a barrel of oil through the pipeline, is important because the more it costs to ship oil to Valdez, the less the oil is worth at Prudhoe Bay. That means less revenue to the state.

The main point of contention today is that a state regulatory agency has set a transportation rate for shipping oil to Valdez that is about half that of the rate for oil destined for Outside consumption. This gap represents a loss to the state treasury of about \$500,000 a day, according to Fineberg's estimates.

A federal judge is the latest to agree that the rates should come down.

The state is now among the parties challenging the oil companies on the higher tariffs, saying that it is discriminatory to charge twice as much for exactly the same service. But a few years ago the state wasn't saying anything of the kind.

The oil companies say the state's new position is "blatantly disingenuous" and an abrogation of the 1985 agreement.

The 1985 deal includes this provision: "State and TAPS carriers shall cooperate, each at its own expense, in securing all necessary governmental approvals for this agreement and in defending against any litigation affecting the validity and enforceability of this agreement or any provision thereof."

The state claims that it is living up to the agreement, while the oil companies are not.

In 2002, six years after Tesoro protested the cost of shipping oil in state, the RCA said the 1985 settlement "provided the carriers the opportunity to earn over \$9.9 billion in excess of the reasonable and prudent costs of providing service" as of 1997.

The state opposed Tesoro's RCA case for many years and then joined with the pipeline owners in appealing the RCA order to an Anchorage Superior Court, but lost.

In February 2006 the state withdrew from the case. It should be simple enough for the Department of Law to explain what took so long.

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State should examine rights, duties under 1985 oil shipping deal

By Dermot Cole
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TAPS CASE: The companies that own the trans-Alaska pipeline say the formula for setting transportation costs is not the sum of its parts.

Disregard the specifics in the 1985 settlement with the state, the oil companies say. There are words like "depreciation" embedded in the text, but such words are meaningless labels outside the context of the settlement.

The only thing that matters, the pipeline owners argue, is that the formula is a package deal that establishes a way to set maximum rates.

The oil companies challenging the pipeline owners say that understanding the depreciation rate and every other element in the 1985 settlement is essential to determining how much the owners should be allowed to collect for shipping a barrel of oil from Prudhoe Bay to Valdez.

Six years after Tesoro protested the cost of shipping oil instate, the Regulatory Commission of Alaska found in 2002 that key financial mechanisms in the settlement — dealing with accelerated depreciation and other benefits — had allowed the oil companies to recover 97 percent of the pipeline's cost by the end of 1996.

The RCA said that the 1985 settlement “provided the carriers the opportunity to earn over \$9.9 billion in excess of the reasonable and prudent costs of providing service” as of 1997.

The owners of the pipeline — led by BP, Exxon and ConocoPhillips — insist that the numbers about depreciation and other items included in more than 100 rate filings with the Federal Energy Regulatory Commission are not what they appear.

The only relevant fact, the companies argue, is that the 1985 settlement was accepted by the owners of the pipeline and the state as a way of producing reasonable rates until 2011.

To look at what the oil companies reported in the rate filings for depreciation and apply that calculation in setting a transportation rate for companies that didn't sign the deal is “cherry picking,” the pipeline owners contend.

Anadarko and Tesoro don't agree. As non-owners of the pipeline, they are pushing for lower transportation costs, which would make their oil more valuable.

On Thursday an administrative law judge agreed with their claim that the specifics of the 1985 settlement should be used in constructing an accurate record of the pipeline's financial past. She decided that interstate transportation rates should be cut in half, to about \$2 a barrel.

This subject has more twists and turns than the Tanana River and that includes the way the state has played or misplayed its position.

Tariffs are important because every dollar in excess transportation costs represents a loss to the state of about a quarter. The total runs to hundreds of millions of dollars a year, according to some reports.

I've written here before that the state's record on seeking lower tariffs is inconsistent. Contradictory might be a better word.

The 1985 deal includes this provision: “State and TAPS carriers shall cooperate, each at its own expense, in securing all necessary governmental approvals for this agreement and in defending against any litigation affecting the validity and enforceability of this agreement or any provision thereof.”

The state's actions of the past few years should lead the Palin administration and the Legislature to examine just what Alaska's responsibilities are under that provision.

Richard Fineberg, an independent Fairbanks oil analyst, has authored authoritative and exhaustively researched reports on the tariff situation over the past two decades. Most of those reports have been ignored by the political establishment and not given the credence they deserve by the news media.

I say this because key findings identified by the FERC staff and the administrative law judge tend to echo the analysis that Fineberg has been making for nearly 20 years.

Fineberg said that upon reading through the judge's decision he pictures the state starring as “The Dog that Didn't Bark.”

“As Judge Cintron works through the various arguments around which TAPS tariffs and the decision revolved, on most of the major points she has no need or reason to mention the state. Considering both the state's interests and the breadth and detail of the decision, I find the state's absence from the decision noteworthy,” Fineberg said.

The heavy lifting in the case is being done by Anadarko and Tesoro, not the state, he said. The state's claim in this proceeding is limited to a narrow point about whether it is discriminatory to have interstate transportation rates more than twice as high as intrastate rates.

The pipeline owners claim the state's position is disingenuous and conflicts with arguments Alaska has made in other proceedings before the FERC, RCA and in state court.

Fineberg said the 1985 settlement does not define what the state must do to cooperate and defend the agreement. He has long questioned whether the state could live up to its bargain without actively fighting the efforts of companies like Anadarko and Tesoro to get lower rates.

The state opposed Tesoro's RCA case for many years and then joined with the pipeline owners in appealing the RCA order to an Anchorage Superior Court. The state claimed the RCA had "abused its discretion," but the court affirmed the RCA ruling in all respects.

In an appeal of the RCA order for lower rates three years ago, the state agreed with the pipeline owners that the "TSM depreciation" based on the 1985 agreement wasn't "actual depreciation." That view has been rejected by the RCA, a Superior Court judge, the FERC staff and the administrative law judge.

In a document filed in July 2004, an attorney for Tesoro said "The state's focus in the proceeding and on appeal seems simply to be that of a party trying to justify a bad settlement."

In February 2006 the state withdrew from an appeal of the RCA tariff ruling, a dispute now leaving the pipeline owners alone before the Alaska Supreme Court.

The withdrawal raises new questions about what was required from the state in terms of cooperating to defend the 1985 settlement.

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Judge finds pipeline owners charge too much for shipping oil

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TAPS TARIFF: It's not final, but the ruling from the administrative law judge on the trans-Alaska pipeline tariff case represents another victory for Anadarko and Tesoro and a setback for the companies that own the trans-Alaska pipeline.

The five-member Federal Energy Regulatory Commission will next consider the matter and a challenge in federal court is likely to follow.

The thrust of the decision is that the pipeline owners are charging about twice as much as they should to pump a barrel of oil from Prudhoe Bay to Valdez.

Judge Carmen Cintron ruled Thursday that the correct figure is closer to \$2 than \$4 per barrel.

The difference is important because lower tariffs mean that North Slope oil is more valuable, particularly for companies like Anadarko and Tesoro that don't own part of the pipeline. The transportation cost is also important to the state because lower tariffs translate into higher oil revenues from royalties and taxes.

On almost every major point in this complicated fight, Cintron sided with Anadarko and Tesoro, rejecting the arguments of the pipeline owners, a group that includes BP, ConocoPhillips, ExxonMobil, Koch Alaska and Unocal.

She said the owners are charging transportation rates that are "unjust and unreasonable" to ship oil out of state.

The lower rates established through a lengthy proceeding by the Regulatory Commission of Alaska for oil used within the state are closer to the mark.

The transportation cost for oil that leaves the state from Valdez is under the jurisdiction of the FERC.

All the combatants in the case agree that it makes no sense to charge about \$2 to ship a barrel of oil to Valdez for instate use and to charge more than twice as much for a barrel of oil that is loaded on a tanker and consumed elsewhere.

The parties differ on what to do about this discrepancy, however.

Anadarko, Tesoro and the state want the lower RCA intrastate rates to apply to all oil, not just the 10 percent or so used in the state.

The pipeline owner companies want the FERC to order an increase in the tariff for oil used in Alaska, claiming the lower tariffs are "an undue burden on interstate commerce" and give Alaska refiners an unfair advantage over refineries in the Lower 48.

Robin Brena, an attorney for Anadarko, said the pipeline owners have been charging excessive rates for shipping oil through the pipeline for 30 years.

"Their excessive rates have cost their shippers and the state of Alaska billions of dollars," said Brena, who has argued this issue in regulatory proceedings for many years.

He said the initial decision of the judge is a "major step toward establishing fair rates" for the pipeline system.

"If upheld, the initial decision will significantly lower transportation costs for ANS (Alaska North Slope) crude oil, increase royalty and severance taxes to the state of Alaska, increase the value of ANS reserves and encourage the further development of those ANS reserves," he said.

One of the central points of the dispute is the 1985 agreement between the oil companies and the state to settle pipeline tariffs.

The pipeline owners say that the individual elements in that agreement listing costs, rates of depreciation and other specifics were never meant to be relied upon by those who did not sign the agreement.

For example, the owners say that that Tesoro and Anadarko can not look at the annual rate filings in which the pipeline owners account for depreciation and say that the numbers are accurate.

Tesoro and Anadarko say the published numbers show exactly what happened and how much money the oil companies collected beyond what they should have been allowed to receive.

The judge rejected the idea that the 1985 settlement is an “inseparable package” and the pipeline owners’ claim that Tesoro and Anadarko are “cherry picking.”

She said the rate filings made by the companies over the past two decades are the most convincing evidence of the pipeline’s financial past.

The FERC allows pipeline owners to recover their investment in a project, but prohibits double recovery. She said she gave no weight to the contention by the pipeline owners that it would be best, for purposes of setting rates, to act as if the 1985 settlement with the state had never occurred and to draw numbers from other sets of books kept by the companies for accounting purposes.

The rate filings made under the 1985 agreement show how much has been recovered.

Richard Fineberg, an independent oil analyst from Fairbanks who has followed this issue for more than two decades, said he had two immediate reactions to the judge’s 116-page ruling.

The first was the extent to which the judge agreed with the FERC trial staff in its “stinging rejection” of the arguments from the pipeline owners.

The second was “the state’s apparent irrelevance to the decision.”

I’ll have more to say on that second issue in Sunday’s column.

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Oil companies still say pipeline’s ‘economic life’ ends in 2011

By Dermot Cole
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TAPS TARIFF: The arcane battle over trans-Alaska pipeline tariffs in Washington, D.C., is a financial struggle between those who own a piece of the pipe and those who do not.

As the main owners of the pipeline, BP, ConocoPhillips and Exxon don't mind paying themselves a hefty fee for shipping a barrel of oil from Prudhoe Bay to Valdez.

The economic theory is that a dollar in the right hand is worth just as much when it is moved to the left hand.

Tesoro and Anadarko are not pipeline owners, however, so they can't shift this expense from one subsidiary to another.

They'd like to see transportation costs as low as possible, which would make oil on the North Slope more valuable.

The two companies have challenged the pipeline transportation rates as "unjust and unreasonable" in a case being argued before the Federal Energy Regulatory Commission.

For the past decade Tesoro has been pushing this point, first before the Regulatory Commission of Alaska and now before the federal board.

The state has a big interest in what happens next. One estimate is that for every \$1 collected by the companies in excessive transportation costs, the state loses 25 cents in royalties and taxes. The loss is roughly \$500,000 a day, according to Fairbanks researcher Richard Fineberg, who has followed this debate for decades.

You would think that the state would have long been fighting for lower tariffs and looking for ways to make North Slope oil more valuable, which could entice more companies to look for oil on the North Slope. But you would be wrong.

The state has been inconsistent in its arguments on transportation costs. It signed a deal with the big oil companies in 1985 on a financial formula for deciding transportation costs and promised to defend it.

After opposing Tesoro's case before the RCA, the state now contends that in challenging the transportation rates it is still defending the deal — it is just attacking the way the oil companies are implementing certain provisions.

In the first detailed look at developing a cost-based rate for pipeline tariffs, the RCA found that the oil companies had recorded \$20 billion in expenses and \$50 billion in income by 1996.

Nearly \$10 billion of the income was "in excess of the reasonable and prudent costs of providing service," the RCA found.

In the current case about interstate rates, an administrative law judge is expected to rule shortly on whether the pipeline owners are charging themselves too much to move oil.

The 1985 deal between the oil companies and the state contained many flaws that would never have passed muster before the FERC because they were not based on costs. Even the oil companies admit that.

The state agreed to the deal, however, and FERC accepted the settlement, leaving the door open for future challenges by those who had not signed the agreement.

The essence of the current dispute is that Tesoro and Anadarko can seek a “just and reasonable” transportation cost derived from a process based on actual costs and precedents established throughout the United States.

The attorneys on the FERC staff agree that the settlement “inherently produces unjust and unreasonable rates that fail to comply with applicable cost-based ratemaking standards.”

The big oil companies say the 1985 tariff settlement is binding as a total package, not as a series of individual elements, and that the claims of their opponents are “groundless.”

Tesoro and Anadarko say the Alaska settlement “resulted in massive overcollections of revenue” by the oil companies, producing a 99.28 percent return on equity in 2005 and a 105 percent return in 2006.

One of the big issues is accounting for depreciation, which is the way in which assets are written off for tax purposes.

The 1985 settlement allowed the oil companies to get those tax benefits on an accelerated basis, meaning the pipeline value would go down faster than through traditional “straight line” depreciation.

This allowed the companies to recover a large part of their investment early in the operational phase of the pipeline’s history. The RCA found that 97 percent of the pipeline’s cost had been recovered by the end of 1996.

This is relevant because costs that have already been recovered should mean a lower rate base and lower transportation costs.

One argument in the debate concerns the life of the pipeline. The shorter its life, the quicker the companies recover their investment and the higher the expense, creating higher transportation costs.

The oil companies are still acting as if the pipeline’s useful life will end in 2011, even though everyone thinks a more realistic date is 2034.

This discrepancy inflates the current depreciation expense by tens of millions of dollars, the non-owners say.

The oil companies argue that they are allowed to say the pipeline’s economic life will end in four years because the FERC has never told them to use a new number.

“Because the TAPS carriers are not the proponents of changing the approved depreciable life ending in 2011 and the commission has not approved such a change, that end-life remains in effect until modified prospectively,” the pipeline owners said.

The non-owners claim the oil companies should have submitted updated depreciation studies that reflect reality.

In general, the pipeline owners say that the depreciation rates determined from the 1985 settlement are an illusion.

They argue that since the FERC did not explicitly say it was approving the accelerated depreciation schedule in the agreement, but merely described it, the formula is not binding.

They say that the commission, in dealing with Tesoro and Anadarko, should act as if the 1985 settlement with accelerated depreciation never existed.

The FERC staff described this argument as "silly," adding that accelerated depreciation has been applied by the pipeline owners in more than 100 rate filings.

VECO VALUES: The Voice of the Times section in the Anchorage Daily News removed the name of Bill Allen, who was publisher, as of Thursday. Now that space is blank, but the contract to publish the section was with Allen.

Allen, who pleaded guilty to bribing legislators and told one of them, "I own your ass," resigned Thursday and his daughter became head of his company.

Still on the VECO Web site is its list of "VECO Values."

The second one is honesty: "We maintain integrity by always matching our actions with our words. We don't lie. We don't cheat. We don't steal."

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Oil pipeline tariff fight should be a key part of gas line debate

By Dermot Cole
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TARIFF CASE: To a greater extent than has been the case to date, the positions taken by the oil companies in the oil pipeline tariff dispute should be part of the discussions in Juneau about any proposals to build a gas pipeline.

Every legislator should be reading the major documents in the Federal Energy Regulatory Commission case about tariffs on the trans-Alaska oil pipeline. An understanding of this background information is needed to ensure that crucial mistakes made by the state on the oil pipeline are not repeated on the gas pipeline.

An administrative law judge is expected to issue an opinion on the case in May, which will be followed by deliberations of the five-member FERC. Whatever the commission decides is expected to lead to a battle in federal court.

The companies that own the oil pipeline — BP, ConocoPhillips and Exxon heading the list — are also the biggest operators on the North Slope. In this case they are trying to defend how much they charge themselves to ship a barrel of oil from Prudhoe Bay to Valdez for consumption outside the state.

The more they charge, the lower the value of the oil on the North Slope for royalty and tax purposes. Attorneys challenging the pipeline owners estimate that the state loses 25 cents when the transportation cost is \$1 too high.

The tariff is also important because the more it costs to ship oil, the more difficult it is for competing oil companies to make a profit on exploring and developing oil resources on the North Slope.

Concerns about promoting future competition and control of the North Slope are at the heart of the gas pipeline debate. The arguments offered in the oil tariff case are particularly relevant to the gas pipeline and lead to questions about whether the pipeline owners would find it in their self-interest to keep gas line tariffs as low as possible.

Among those who say the rates on the oil pipeline are excessive are two companies that don't own a piece of the pipeline — Tesoro and Anadarko — along with the state and the staff attorneys of the FERC.

A decision by the Regulatory Commission of Alaska in 2002 led to a cut in transportation rates of about 50 percent for those who shipped oil to Valdez for use within Alaska. The higher rates remain for oil that goes Outside.

Independent oil and gas analyst Richard Fineberg of Fairbanks, who has been raising key issues in this debate for many years — while many state officials have [remained] silent on the matter — estimates that the higher charges are costing the state treasury \$400 a minute, or more than \$500,000 per day, in reduced taxes and royalties.

In its FERC filing, the state says its protests of transportation rates “raise a single, simple question — can the TAPS carriers charge vastly different rates for transportation of oil solely on the basis of where the shippers take their oil after it leaves TAPS? The answer to that question is quite straightforward — they may not.”

The state is not challenging the interstate rates directly. That's because the state agreed to a 1985 deal with the oil companies called the TAPS Settlement Methodology or TSM. That settlement included a provision — one that seems quite reckless in retrospect — that the state had an obligation to defend the deal.

So the challenge is indirect. It is based on a state claim that it is against federal law to impose different tariffs for the same service.

"The state's position is blatantly disingenuous," the pipeline owners said in March, rejecting claims of discrimination.

The oil companies say the state can't claim discrimination because in the 1985 deal, the state agreed that the rates under the TSM were "just and reasonable and non-discriminatory" within the meaning of the Interstate Commerce Act. The contract bars the state from claiming discrimination, the companies claim.

"Having agreed to support TSM, the state should not be permitted now essentially to abrogate its own settlement," the oil companies argue.

In the filings on the case, which now run to more than 7,000 pages of transcripts and 800 exhibits, Anadarko, Tesoro, the RCA and the FERC staff have highlighted numerous defects in the 1985 agreement with the state.

One of the main contentions by Anadarko and Tesoro is that they were not parties to the 1985 agreement and therefore they don't have to abide by it. They are seeking action by FERC to set "just and reasonable rates," a standard that the pipeline rates were not subjected to.

The complicated arguments in this case are worth examining in some detail, which I plan to do here over the next few weeks.

What may be particularly damaging to the oil companies is the position taken by the FERC staff attorneys, who are independent. The oil companies say the FERC attorneys' "unqualified support for the positions asserted by Anadarko/Tesoro and the state is utterly mystifying."

The FERC staff said it is concerned that positions taken by the oil pipeline owners "are not only directly contrary to the orders which approved the TAPS settlement over 20 years ago, but contrary to some of the most basic notions of calculating just and reasonable rates, as well."

It said that the positions taken by Anadarko, Tesoro and the state are consistent with the FERC's prior orders concerning the trans-Alaska pipeline and precedent.

"It is important that the commission reaffirm its established ratemaking standards in this proceeding and, as the record herein demonstrates, there is no legal, logical or equitable reason not to do so," wrote Dennis Melvin, who directs the FERC legal division.

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