From the desk of ***Richard A. Fineberg***
P.O. Box 416, Ester, Alaska 99725
Phone / Fax (907) 479-7778 ∘ E-mail: fineberg@alaska.net

July 2, 2007
(Rev.)

Representative Carl Gatto, Chair
House Resources Committee
600 E. Railroad Ave.
Wasilla, AK 99654

Representative David Guttenberg
1292 Saddler Way, Suite 304
Fairbanks, AK 99701

Re: Department of Law's June 28, 2007 Response to "Twenty Questions on Trans-Alaska Pipeline System Tariffs and State Management Issues"

Dear Representatives Gatto and Guttenberg:

Thank you for submitting the questions I prepared for the House Resources Committee's June 7 hearing on TAPS tariff issues to the Department of Law for response. Unfortunately, in its June 28 response the Department of Law has declined to answer 15 of the 20 questions I posed in my testimony, including all questions regarding prior litigation. As I noted when I created this checklist, certain historical questions are relevant because "TAPS tariff management issues demonstrate anew, in the Spring of 2007, the maxim . . . that those who do not understand history are compelled to repeat it." Compounding the difficulties of operating without historical perspective, in discussing current litigation, the Department of Law notes that its responses to the few, carefully selected issues it is willing to discuss are constrained because its opponents diligently search for "statements by State representatives that they could use or twist to their advantage." As one who has helped prepare administration materials on oil and gas litigation for legislative review and reports to the Legislature on the same subjects in the past, I can appreciate the Department of Law's tactical concerns. But the fact remains: If the administration does not provide the Legislature with meaningful answers to substantive questions about the background, development and execution of public policy, this reticence places legislators at a severe handicapped in conducting effective oversight and policy review on behalf of the public.

Before turning to the issues the Department of Law chose to discuss in its June 28 comments, it will be useful to review briefly the reasons TAPS tariff issues warrant your careful attention. As you know, the Regulatory Commission of Alaska's 2002 decision and order on TAPS tariffs, determined that then State lost more than $2.0 billion in revenue during the first two decades of North Slope production due to excessive pipeline tariffs permitted under the 1985 TAPS tariff agreement between the State and the TAPS Owners. Further, the commission determined that its current tariff level of $1.96 per barrel enables TAPS owners to cover all expenses, including a reasonable profit on pipeline investment and operations. The RCA decision has been upheld in a 2006 Superior Court (currently under review by the State Supreme Court) and its results have

been validated by the FERC Trial Staff and, most recently, the May 17 decision of the FERC Administrative Law Judge presiding over current TAPS tariff protests at FERC. Presently the TAPS owners are charging tariffs in excess of $5.00 per barrel for most of the oil shipped on TAPS under the 1985 agreement. I estimate that this overcharge reduces producer payments to the State by approximately $500,000 per day. I stand by my description of this revenue as lost to the State. The Department of Law is now trying to get at least a portion of that lost revenue back for 2005, 2006 and 2007. Refunds for 2004 – and all prior years – appear to be unrecoverable. Had the Department of Law responded more promptly to the plight of the independent shippers forced to pay what the RCA, Superior Court and FERC Trial Staff and Administrative Law Judge have found to be excessive tariffs under the Department of Law's ill-conceived 1985 settlement, it is reasonable to assume that the resulting expedited tariff protest process would have enabled the State to bank a considerable portion of that revenue as a matter of course. This broad understanding, based on participation in State policy and supported by documentary record established by subsequent research from a variety of external consulting perspectives, underlies the recommendation that petroleum pipeline tariff management is a policy issue whose broad outlines should be determined, like any other State function, by a line agency.

Apart from the direct fiscal consequences for the State Treasury, a second underlying policy question requires consideration: Over the course of three decades, it has become clear that the State, despite its statements to the contrary, does not stand in the shoes of the TAPS shippers but instead leaves it to the shippers to make the central arguments against tariff overcharges. In fact, for nearly eight years, the Department of Law actively opposed independent shipper efforts to secure lower tariffs at the RCA. Does the State's failure to demonstrate the ability and the will to ensure just and reasonable pipeline tariff levels inhibit independent explorers from engaging in the search for the additional undiscovered supply of natural gas on the North Slope necessary to make the proposed natural gas line a success?

Turning to the five issues discussed by Senior Assistant Attorney General Philip Reeves in the Department of Law's June 28 response to the questions I submitted June 7:

1. The Department of Law reports that the current Attorney General and his staff are working closely with the Departments of Law and Natural Resources; I applaud that fact. But this happy, momentary circumstance should not obscure the fact that pipeline tariffs exist in an administrative limbo in which no agency is expressly granted tariff oversight authority by statute. Review of the historical questions the Department of Law declined to address provides numerous examples of problems that developed – and, in the absence of policy guidance from an agency with formal responsibility for setting the petroleum pipeline tariff policies implemented by the Department of Law – linger unresolved today, to the detriment of State interests.[1]

2. The Department of Law asserts that "suggestions that the State has lost revenues because the TAPS Carriers are permitted to charge the protested TAPS rates are false, as they ignore the protection of the refund condition."[2] The department's

[1] See question 20 of my June 7 testimony, with particular reference to AS 42.06.140(a)(10).

[2] Letter from Senior Assistant Attorney General Philip A. Reeves to Representatives Carl Gatto and David Guttenberg, June 28, 2007, p 4.

stated reliance on "the refund condition" ignores the fact that once a tariff is in place, it is not certain that tariffs can be reduced later to secure refunds. Pursuit of refunds is an inherently time-consuming and uncertain exercise. In fact, at the time of the 1985 settlement, the anticipated difficulty in collecting refunds was one of the principal factors that led the State to give up the majority of the refunds arguably owed the State in exchange for promises of reduced future tariffs; critics of the settlement (this writer included) felt that the refund claims for eight years of shipment at arguably excessive tariffs should have been pursued vigorously to establish a clear precedent, despite the inherent difficulties, and that lower future tariffs would have been achievable in any event through normal ratemaking processes, without giving up refund claims. In discussing the current tariff protest, the Department of Law does not mention that its present case does not secure refunds for overcharges during 2003 or 2004. It should also be noted that in the current case, the FERC law judge adopted a precedent that prevents the 2005 and 2006 TAPS rates from being fully reduced, thereby allowing only partial refunds for those years. (The Department of Law hopes that its argument against discriminatory rates will prevail in this context to produce full refunds, as the Department of Law acknowledged in its June 7 testimony and its June 28 letter.) In short, the Department of Law's current course of action is a commendable effort to dig out of a hole by seeking to recover some of the revenue lost due to high filed TAPS tariffs.

3. The Department of Law's third discussion point – that statutory regulatory procedures give the TAPS Owners the right to set tariffs that may be challenged by shippers – is a general description of ratemaking principles and practices that are not at issue here. From the standpoint of public policy, constructive deliberations might focus on whether the Department of Law, in the absence of firm policy guidance from a line agency, has been able to challenge excessive TAPS tariffs in a vigorous and timely manner. Review of the historical record suggests that the Department of Law's past performance has enabled the TAPS Owners to continue to underpay State royalties and production taxes for extended periods.[3]

The effort to recover a portion of the current revenues lost due to these overcharges is commendable: When you're in a hole, stop digging. But in my estimation this public policy question needs to be addressed: How did we get into this hole? As discussed in the next section, more timely efforts to stop supporting excessive tariffs under the 1985 settlement agreement might have delivered lower filed tariffs that would have stimulated development and avoided lost revenues (and the necessity for the current legal maneuvering that may or may not prove successful in securing partial refunds).

4. In its June 28 letter, the Department of Law focuses at some length on the State's duty to defend the TAPS Settlement Agreement and criticisms of the efficacy of the State's discrimination protest. This section of the June 28 letter begins with the statement that "[t]he TAPS settlement generally imposes a contractual duty on the State that in essence requires the State to support and defend TAPS rates filed in conformance with the TAPS settlement agreement."[4] That's not exactly what the settlement says. The settlement requires that each party "cooperate . . . at its own expense . . . in defending against any litigation affecting the validity and enforceability of

[3] See page 5 of my June 7 testimony and item 4, below.

[4] Reeves to Reps. Gatto and Guttenberg, p. 4.

this Agreement, or any provision thereof."[5] On its face, this contractual requirement has limits that are not evident from the Department of Law's description. The practical effect of these limits, overlooked by the Department of Law in its June 7 testimony and June 28 letter, was clearly demonstrated on Feb. 28, 2006. On that date, the State, which had joined the TAPS owners in vigorously opposing the independent shippers at the APUC/.RCA and in court for nearly eight years, withdrew from the case by serving a simple notice that the State did not intend to appear before the State Supreme Court to defend the settlement.[6] State withdrawal from the independent shippers' long-running challenge to intrastate tariffs suggests that the Department of Law might have fulfilled its legal obligations without vigorously participating in the TAPS owners' defense of the 1985 settlement. Instead, for nearly eight years the Department of Law steadfastly opposed the State's immediate fiscal interests.[7] At the same time, by adopting and then choosing a strict interpretation of the settlement clause requiring the State to cooperate in defending the settlement, the Department of Law effectively reversed the State's proclaimed policy of representing shipper interests on TAPS.[8]

Earlier this year, in the FERC case the State further probed the limits of its obligation to cooperate in defending settlement tariffs when it 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."[9] In this case, the State apparently got around its presumed obligation to defend settlement tariffs by arguing that it was not challenging the tariff itself, but the TAPS owners' hypothetical tariff. From a policy standpoint, one might ask: Why didn't the State challenge the hypothetical tariff calculations presented by the TAPS owners in the RCA case years earlier? Instead, as noted above, the State continued to lend its support to the high tariffs permitted under the 1985 settlement agreement that the RCA found to be excessive in 2002.

5. In the final question the Department of Law elected to discuss, I asked for specific information that would provide clear understanding of the amounts the State has paid the attorneys and associates of Morrison & Foerster for its work on TAPS tariff

---

[5] *Settlement Agreement Between the State of Alaska and ARCO Pipe Line Company, BP Pipelines Inc., Exxon Pipeline Company, Mobil Alaska Pipeline Company and Union Alaska Pipeline Company With Respect to the Trans Alaska Pipeline System*, June 28, 1985 (Federal Energy Regulatory Commission Docket No. OR78-1), Sec. I-3 The Department of Law does not explain how and when (or whether) the specific contractual requirement to cooperate with the other settling parties in their defense of the settlement was transformed into a general obligation to "support and defend" the settlement.

[6] Attorney General, State of Alaska, *Notice of Non-Participation*, Feb. 28, 2006 (Supreme Court for the State of Alaska, in Case No. S-12230 [Amerada Hess Pipeline Corp., BP Pipelines [Alaska] Inc., ExxonMobil Pipeline Company, Phillips Transportation Alaska, Inc. and Unocal Pipeline Company [Appellants] vs. Regulatory Commission of Alaska [Appellee]).

[7] As I noted in my prepared testimony June 7, "…since 2002, a slew of important decisions and statements have borne out the concerns of critics of the 1985 TAPS tariff settlement. The 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. 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."

[8] "Alaska stands in the shoes of both past and future shippers . . . . Alaska's interests are coextensive with shippers." (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 the Federal Energy Regulatory Commission with TAPS settlement offer, June 28, 1985], p. 18.)

[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. 86.

issues during the past decade. I sought this information for two reasons: (a) Morrison and Foerster's lead counsel on Alaska matters was directly involved in the 1985 TAPS settlement and (b) according to the *Alaska Budget Report*, that firm received approximately $12.3 million between July 2003 and the end of 2006 for legal services and negotiations – approximately four times the amount any other consulting firm was paid for work on the proposed natural gas line under the Murkowski Administration.

Instead of answering the questions I posed with specific information on amounts paid to Morrison & Foerster and its associates, the Department of Law noted that potential gains from reduced TAPS tariffs far outweigh current expenditures on TAPS tariff litigation. While I firmly believe that substantive response to questions I posed in this regard will further review and understanding of petroleum pipeline tariff issues, I also want to make it clear that I agree with the Department of Law's argument that TAPS tariff litigation gains are likely to far outweigh expenses. The potential pay-offs on TAPS tariff litigation provide another indication of the importance of TAPS tariffs policy and case management issues.

In closing, I note that 15 of the 20 questions I posed in my June 7 testimony checklist list that remain unanswered cover the following important subjects:

- Question 2: State CY 2004 TAPS tariff overcharge protest at FERC
- Question 3: State CY 2005 and CY 2006 TAPS overcharge protests at FERC.
- Question 4: Fiscal outcomes of other tariff protests since 1996.
- Question 5: Tariffs below TAPS Settlement Agreement ceiling.
- Question 6: Tariff levels (difference between TSM tariffs and just and reasonable tariffs)
- Question 7: Depreciation (shift in State treatment of depreciation)
- Question 8: Per-barrel allowance
- Questions 9 and 10: State policy toward independent shippers
- Question 11: Antitrust issues (Conoco's 1993 departure and Maritime Endeavor lawsuit)
- Question 14 and 15: TAPS Tariffs under TSM v. Explanatory Statement Prognostications
- Question 16: DR&R issues (dismantling, removal and restoration)
- Questions 17 and 18: Relative importance of natural gas pipeline tariffs compared to oil pipeline tariffs (as percentage of barrel of oil equivalent).

In sum: Despite improved inter-agency cooperation, petroleum pipeline tariff issues still suffer from lack of firm policy direction. The pernicious effects of this management problem become clear when TAPS tariff issues are reviewed in their historical context. To assure that inadequately reviewed tariff decisions do not continue to undermine fundamental State policy goals, I hope your oversight efforts will lead you to recommend statutory vesting of responsibility for tariff policy decisions with a line agency. With thanks again for your consideration, I am

Sincerely,

Richard A. Fineberg

Cc: Sr. AAG Philip A. Reeves