

TAPS

LITIGATION

SETTLEMENT

5-7-82



Alaska State Legislature

SENATE Resources Committee

Official Business

BETTYE FAHRENKAMP, Chairman
VIC FISCHER, Vice-Chairman
BRAD BRADLEY
DICK ELIASON
DON GILMAN
BOB MULCAHY
ARLISS STURGULEWSKI

TAPs LITIGATION SETTLEMENT HEARING

May 7, 1982
4:00 p.m.

Governor's Conference Room

POUCH V
STATE CAPITOL
JUNEAU, ALASKA 99811
(907) 465-3834
(907) 465-3835

SENATORS PRESENT

Senator Fahrenkamp
Senator Bradley
Senator Colletta
Senator Dankworth
Senator Fischer
Senator Gilman
Senator Ker'illa
Senator Mulcahy
Senator Parr
Senator Sturgulewski

REPRESENTATIVES PRESENT

Representative Halford
Representative Adams
Representative Brown
Representative Bylsma
Representative Cotten
Representative Hayes
Representative Malone
Representative Randolph
Representative Sutcliffe
Representative Vaska

Wilson Condon, State Attorney General, outlined the six issues he sees in the settlement agreement:

1. The resolution of the rate issue between Prudhoe Bay and Fairbanks.
2. The tariff level from 1993 on, to address the objections of the U.S. Justice Department.
3. The letter from Dennis Melvin, FERC trial staff.
4. The likelihood of refunds.
5. The likelihood of lower tariffs in the future than what is in the settlement agreement.
6. The FERC decision-making process.

Robert Loeffler, Loeffler, Morrison, Foerester, D.C. Counsel to the Attorney General, in regard to Melvin's letter, explained that the FERC trial staff advocates the consumers' interest, and doesn't represent the views of the Commission. In addition, despite the recommendation Melvin made in his letter, he personally told Loeffler that he thought the FERC Commission would approve the settlement agreement. Loeffler stated that in making the settlement agreement, probabilities of different alternatives were judged, and the result is his best informed judgment. Noting that the burden of proof in this case is on the State, that the Commission could handle the case in a way that could lead to its dismissal, and that the possibility of getting a dollar settlement from FERC is not good, he urged the Legislature to accept the settlement agreement.

Condon explained that last year the minority members of the House urged that a settlement be negotiated. After meetings with many attorneys, a white paper was presented to the Governor, who then directed that a settlement agreement was appropriate. The Justice Department and FERC were also presented with the white paper.

Loeffler believes the pipeline companies will accept the settlement agreement, as it will bring their costly litigation to an end, and add certainty to the tariff issue. However, the settlement does expire in ten years, so a controversy on rate making methodology could begin anew at that time.

Representative Halford moved that the Committee go into Executive Session to discuss matters that directly affect the finances of the State. Unanimous consent was asked.

EXECUTIVE SESSION
(NO MINUTES TAKEN)

Representative Randolph expressed concern over the Governor's direction that he will accept the settlement agreement unless the Legislature disapproves it. Randolph feels more time is needed to adequately decide the issue.

Condon stated that if the Legislature takes no action, the Governor can indeed accept the settlement, but stated he is committed to settling three issues prior to acceptance: 1) rates to Fairbanks 2) quality bank issue 3) opposition of the Justice Department to the settlement's 10-year life span. Condon sees little risk of losing the gains in the current settlement by not ratifying it right away.

Representative Cotten expressed concern over the affect of possible deregulation of pipelines on the settlement. Condon finds the possibility of deregulation low, which he considers a point in favor of the settlement agreement.

Jacob Billig, Billig, Sher & Jones, Counsel to MAPCO, representing North Pole Refinery, stated that North Pole's ability to compete in the refinery industry is dependent on the well head price of the oil and the TAPs tariff charge. The settlement agreement will have an adverse affect on North Pole, as the increase in the well head price will mean increased costs to the consumer, and the agreement fails to accord any refunds of the tariff charges paid by North Pole since 1977. Billig would like to see a lower transportation rate to Valdez, and an adjustment in the intrastate rate. However, if these matters are resolved, as the Attorney General has indicated they will be, North Pole Refinery would favor the settlement.

Representative Cotten stated that there is no real settlement for the Legislature to ratify until all loose ends are tied up, and that time is too short for the Legislature to have significant involvement in the settlement agreement.

Burt Sharp, Comptroller, Golden Valley Electric Association, Fairbanks, is concerned about the increased cost to the consumer the settlement agreement would provide. A tariff (transportation) reduction of \$1.35 per barrel is being realized in an equal increase in well head value. Because of the location of both the North Pole Refinery and GVEA along the pipeline, they pay a percentage rate of well head value, and any

increase in well head value increases the cost to consumers. He suggested that a mechanism be devised so that the Alaska users' cost of crude won't increase, and urged proper resolution of the quality bank issue.

Kevin McCarthy, Counsel, Joint House Oil and Gas Committee, expressed opposition to the settlement agreement, stating all the State has to lose if it doesn't accept the settlement is attorneys' fees. He cited as problems the 10-year life of the agreement, the risk of deregulation, and the fact that the attorneys representing the government in TAPs since 1977 (John Cleary, Ed Tumey, Terry Lindsner) have not presented their opinion on the settlement. He stated that cheap transportation is necessary to the future development of the North Slope, and views the long time frame of the litigation of the case as an opportunity for refunds to continue accumulating. McCarthy concluded by saying that if the Legislature disapproves this settlement agreement, they will probably have a better one before them in several months.

Jerry McCutcheon expressed opposition to the settlement, stating that the fact th State is negotiating is delaying FERC's settlement of the case.

Representative Halford suggested that the Committee go the Governor to determine the potentials on deferring action, and asked that another meeting be held on the TAPs settlement, with Cleary, Tumey, and Lindsner present.

The meeting was adjourned at 6:50 p.m.

Joint Meeting
of
The Senate Resources Committee and the House Oil and Gas Committee
to
Review the Proposed TAPS Litigation Settlement

Thursday, May 12, 1982
3 P.M.

House Finance Room, Capitol Building

Senate Resources Committee

Sen. Bettye Fahrenkamp - Chairman
Sen. Bradley
Sen. Eliason
Sen. Fischer
Sen. Gilman
Sen. Mulcahy
Sen. Sturgulewski

House Oil and Gas Committee

Rep. Rick Halford - Chairman
Rep. Bylsma
Rep. Cotten
Rep. Montgomery
Rep. Randolph
Rep. Rogers
Rep. Vaska

Agenda

1. Department of Law, Introduction of Counsel
2. Review of TAPS litigation, Phase I and Administrative Law Judge Kane's decision - by D.C. Counsel
3. Legislators - comments - motions
4. Executive Session
5. Adjournment

LAW OFFICES
BILLIG, SHER & JONES, P. C.

JACOB P. BILLIG
TERRENCE D. JONES
STANLEY O. SHER
JOHN R. ATTANASIO
MARC J. FINK
JEFFREY F. LAWRENCE
MARK J. FRITZ
ANTHONY J. CICCONE, JR.
DOROTHY L. NICHOLS
SANDRA L. RICHARDSON

SUITE 300
2033 K STREET, N. W.
WASHINGTON, D. C. 20006

TEL. (202) 223-8270
CABLE: 315JO
TELEX: 89-569

May 13, 1982

The Honorable Bettye Fahrenkamph, Chairman
Senate Resources Committee

The Honorable Rick Halford, Chairman
House Oil and Gas Committee

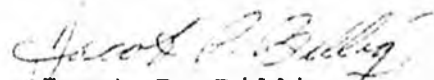
Dear Senator Fahrenkamph and Representative Halford:

In reference to the written summary which has been prepared of the May 7, 1982 TAPS Settlement Hearings, we would like to request that the additional two points, not set forth in the summary, be indicated since they were part of our presentation of the position of the North Pole Refinery:

1. The intrastate tariff rate from Pump Station #1 to North Pole should be adjusted in a manner so that the delivered cost of crude oil does not increase as a result of the settlement.
2. The Quality Bank litigation be resolved.

We would request that this clarification be included in the official summary of the hearing. For the record, I am attaching a written copy of the text of my May 7 presentation.

Very truly yours,


Jacob P. Billig
Counsel to North Pole Refinery

Enclosure

AGO 886264

MAY 7, 1982 STATEMENT OF JACOB P. BILLIG
ON BEHALF OF THE NORTH POLE REFINERY
TO THE ALASKA LEGISLATURE'S JOINT GAS PIPELINE COMMITTEE

We appear here today on behalf of North Pole Refinery which operates the only refinery in the Interior of Alaska at Fairbanks. As many of you are aware, this Refinery has been in operation since August of 1977. Since that time it has been furnishing refined products, including jet fuel, home heating oil and turbine fuel, to the citizens of the Interior of Alaska. In addition, the Refinery serves the outlying Bush areas and has recently begun selling jet fuel in the Anchorage market thus reducing the dependency of that market on West Coast suppliers.

The ability of any interior Refinery to compete in these markets is, substantially dependent upon two interrelated factors:

- (a) the well head price of the oil; and
- (b) its TAPS tariff charges.

We are appearing here today because both of these factors are affected by its proposed settlement of the Trans Alaska Pipeline case pending in Washington before the Federal Energy Regulatory Commission. Before addressing the merits of the proposed settlement agreement, I should point out that the North Pole Refinery transportation costs, and in turn the cost to consumers in the Interior of Alaska, are directly impacted by a variety of tariff rates and charges assessed by the TAPS carriers. Thus, in addition to the tariff charge for the transportation of oil from Pump Station 1 to Valdez which the Refinery pays with respect to some 30,000 barrels per day, it also pays a transportation rate with regard to the movement of oil from Pump Station 1 to the North Pole Refinery at Fairbanks. In addition, the carriers have assessed a so-called Quality Bank charge on the North Pole return oil movements. This charge is currently at a rate of 15 cents per degree API or approximately \$2.10 per barrel of product. Under the methodology which the carriers have proposed, the Quality Bank charge could exceed \$5 a barrel.

Since 1977, the North Pole Refinery has been seeking in various litigations to secure reasonable rates and charges for its movements

from the TAPS carriers. To a certain degree it has been successful before the Alaska Pipeline Commission, predecessor to the APUC, in securing a mileage-based rate for the movements to North Pole. However, that rate is presently being challenged by the carriers in court. With regard to the rate to Valdez, there has been an initial decision by the FERC Administrative Law Judge, Judge Kane. The Quality Bank case is pending before the same judge. Thus, in neither case has there been any final resolution by the FERC.

The settlement agreement proposes to deal with only one aspect of North Pole's transportation charges -- the rate to be assessed for the Valdez movement. It does not seek to settle the controversies still outstanding with the TAPS carriers with respect to the intermediate point rate to North Pole or the Quality Bank charge. The fact that the proposed settlement addresses only a small part of its problems with the TAPS carriers is a major difficulty which the North Pole Refinery has with it.

Insofar as the Interior's interests are concerned, it is in any event clear that the effect of the proposed settlement upon the Refinery and its customers will be adverse. The Fairbanks rate is constructed as a percentage of the Valdez rates. An increase in the interstate Valdez rate thus would mean, if adopted for intrastate purposes as is likely, an increase in the intrastate Fairbanks rate. On the other hand, a decrease in the Valdez rate would also result in increased costs to the Interior since it would result in an increase in the well head price. In this respect, under the settlement which has been proposed, the cost per barrel of oil products will increase by \$1.37. This is a cost, unless there is a countervailing reduction in the intrastate Fairbanks rate, which would have to be borne by the consumers in the Interior of Alaska as well as in the Bush. It would also seriously disable efforts to supply needed fuels to the Anchorage market which are shipped on the Alaska Railroad.

Finally, the Refinery has difficulty with the proposed settlement because it fails to accord any refunds of tariff charges which have been paid by North Pole since the early part of 1978. As a public company with a duty to its stockholders as well as to its customers in maintaining a viable refinery operation, the North Pole Refinery cannot overlook these refunds.

The interests of the North Pole Refinery and the energy consumer in Alaska which I have described were initially not fully

Statement of Jacob P. Billig
May 7, 1982
Page 3

understood and taken into account in reaching the proposed settlement. We were pleased and gratified to hear today from the Attorney General that this will be rectified and that the issues I have outlined will be resolved as a condition to any acceptance of the settlement. Assuming that the rate and Quality Bank issues are resolved in a manner which meets Alaska energy needs, the North Pole Refinery will fully support the proposed settlement.

(In answer to a question from a member of the Committee, I clarified that North Pole's position is not that there must be higher rates to Valdez in order to serve its interests. I pointed out that while a lower rate to Valdez does disadvantage North Pole and the Interior in that it results in an increased well head price, we believed this could and should be handled by adjusting downward the intrastate rate to North Pole. In this respect, I noted that the movement of the "bottleneck" to a point south of the Refinery made it reasonable to accord such reduction.)

Jacob P. Billig

May 14, 1982

The Honorable Jalmar Kerttula
President, Alaska State Senate

and
The Honorable Joe Hayes
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mr. President and Mr. Speaker:

I previously sent you a letter concerning the settlement of the Trans Alaska Pipeline System (TAPS) rate case, which basically stated that I intended to proceed with the proposed settlement unless the Legislature passed a resolution disapproving the settlement. I stated that I still believed this proposed settlement was in the best interest of the State and that it would immediately increase State revenues by \$200 million per year. This was concluded to be better than the expected present value of the various possible outcomes of the litigation. Moreover it would give present certainty to a dispute that otherwise may very well continue into the next decade and in the process incur additional costs.

I asked for legislative participation because this issue has tremendous financial consequences to the State. The response thus far has been at best skeptical due, in large part, to the recently emerging opposition of various other parties in the litigation, such as the F.E.R.C. staff. Although that opposition arises as a result of the different and separate interests of those parties, it nonetheless has raised concerns for many legislators. In addition, even if a negating resolution is not passed, there will remain a substantial cloud over the settlement. Silence will not be seen as support.

I do not believe that the interests of the State are well served if an issue of this magnitude is settled with such a pall hanging over it. Moreover, unfortunately, because of the timing of the settlement process and the upcoming changes in both the administration and the Legislature, delay would likely simply substitute for abandonment.

AGO 886268

The Hon. Jalmar Kerttula
The Hon. Joe Hayes

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May 14, 1982

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The issue must be resolved one way or another this session. For me to approve it requires that the Legislature show support for the proposed settlement. My current perception of the legislative attitude is one of doubt. Whether that perception is accurate or even if the Legislature as a whole actually supports the settlement, I am now concerned that this perception will not be dispelled by the failure to pass an opposing resolution. Therefore, I have decided not to proceed with the settlement unless the Legislature passes a resolution supporting the settlement.

Several legislators have suggested that the matter be referred to an interim committee for two to three months and then have the committee report its decision to the executive branch. I do not think this is an acceptable alternative. It is most preferable to the State to have this case decided expeditiously if we cannot achieve a settlement. As long as the settlement process continues the F.E.R.C. will not seriously consider deciding the case. We already have direct knowledge that the F.E.R.C. has put the case on its "back burner" while our settlement discussions have been ongoing. Delay favors the pipeline companies. The longer the delay in resolving the case, the more difficult it will be for the F.E.R.C. to order the substantial refunds and the dramatically lower rates that would be the best possible outcome for the State.

A decision to pass for a potential big victory in the future or to take \$200 million per year now is a major public policy decision. It is as much an important policy decision as decisions on operating or capital budgets, spending limits, or other important State matters. As such, I believe legislative participation in this decision is most appropriate. While I remain confident that we have negotiated the possible settlement, I will not proceed unless you approve it.

Sincerely,

Jay S. Hammond
Governor

bcc: Attorney General Wil Condon
Susan Greene
JSH:lsg

AGO 886269

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

JAY S. HAMMOND, GOVERNOR

POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

May 14, 1982

The Honorable
Richard W. Halford
House of Representatives
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Representative Halford:

Although there has not yet been a formal communication, I understand that the Joint Gas Pipeline Committee is inclined toward disapproving the proposed TAPS settlement. In addition, I understand that there is also a desire of many members to see Phase II settled by itself.

First, I would like to commend the committee for its handling of a very difficult and complex matter. Although I disagree with your conclusions, my staff and I were very impressed by the deliberation and care taken by members of the committee. The inquiry was thoughtful, the questioning intelligent, and the care taken was evident. The members are to be congratulated and thanked for the time invested at a point in the session when many other issues were pressing. Even though I do not concur with the result, the committee's decision was made in a very responsible and intelligent manner.

Although I will attempt to settle Phase II of the case, in my opinion, the possibility of getting a reasonable settlement with the companies is very slim.

Based on my discussion with their in-house counsel as recently as this week, I believe that they view Phase II as a means of delaying the ultimate resolution of Phase I. Since the "big dollars" are tied in with the Phase I issues, their perception is that dragging out the entire proceeding works to their advantage since they continue to collect a weighted average tariff of \$6.00 per barrel while the case continues. Nor do they see any significant litigation costs associated with this tactic. Since their Phase II case preparation has been completed, their major expenditure on the case is over. In short, they believe that time is on their side and that Phase II is our Vietnam. Whether or not their perception is correct, it is their present belief. Obviously, as long as they hold that view an acceptable

AGO 886270

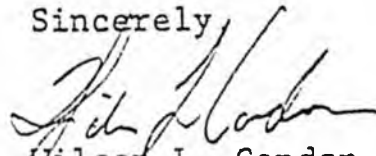
May 14, 1982

settlement is unlikely. Therefore, although I will make the attempt, I am not optimistic.

Without an overall settlement, the litigation will proceed and our present litigation request of \$4.5 million to fund the TAPS litigation to February 15 is now absolutely necessary. Moreover, I would urge the legislature to fund the TAPS litigation for the entire fiscal year, and thus restore the funding to the originally requested \$7,380,000. I do not think the State will be well served if the next Attorney General is placed in the position of having to fight for a TAPS supplemental as one of his or her first responsibilities.

Again, I wish to thank the committee for their care and thoughtful deliberation. You were faced with a difficult and complex decision that had to be made quickly. Although I disagree with your conclusion, I believe you acted responsibly.

Sincerely,



Wilson L. Condon
Attorney General

WLC:mr



Alaska State Legislature

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Representative Bettisworth
Representative Brown
Representative Bylsma
Representative Cotten
Representative Hayes
Representative Malone
Representative Randolph
Representative Rogers
Representative Vaska

Wilson Condon, Attorney General, reassured the Committee that the rate issue between Prudhoe Bay and Fairbanks would be resolved before acceptance of the settlement agreement.

Jacob Billig, Counsel to Mapco, stated he had prepared an addition to the minutes of the May 7, 1982 TAPs Litigation Settlement hearing that he would like included as part of the written record. (Copy attached.)

Terry Lindsner, D.C. Counsel, stated he had been retained to investigate any imprudent costs in the pipeline construction. He feels that the State has a very strong case in Phase 2 of the TAPs litigation, but supports the idea of a settlement to reduce the uncertainties, risks, and continued expense to the State and its citizens.

John Cleary, D.C. Counsel, stated that he has been active in the rate making methodology which led to Judge Kane's decision, and in determining the service life of the line. He stated that settling in favor of the client should always be sought.

Condon stated that whether or not to settle is a judgment that must be made, first by the Attorney General, then by the Governor, then by the Legislature. This judgment depends on the pursuit of particular State policy goals. The D.C. Counsel is not involved in making this judgment, but in determining the likelihood of refunds, of the Kane decision being upheld or modified, and of what future tariffs might be. Condon

TAPs LITIGATION SETTLEMENT HEARING

May 13, 1982

Page 2

outlined four possible policy questions: being a trustee of public resources and seeking certainty; being a trustee but disagreeing with the evaluations; accepting that the State may always be involved in litigation with the oil companies; continuing with litigation as a way of avoiding the issue. Condon feels that a decision on the settlement agreement must be made soon, because the State will be injured by a delay.

Cleary relayed a statement made by FERC Chairman Butler regarding the TAPs case. Butler thinks the case is subject to a fairly definitive settlement agreement, and hopes FERC will not have to spend the time and resources deciding the case.

Condon's opinion is that certainty of income to the State is more important than a settlement of methodology issues. He stated that FERC is such a political body that it can have no "rules".

Senator Fahrenkamp moved and asked unanimous consent that the Committee go into Executive Session, as immediate knowledge of issues to be discussed would have an adverse impact on the finances of the State.

Representative Rogers moved and asked unanimous consent that the Committee meet first with the D.C. Counsel, and then separately with the Attorney General.

EXECUTIVE SESSION
No Minutes Taken

Jacob Billig, D.C. Counsel to Mapco, reminded the Committee of the three issues that must be satisfied before North Pole Refinery would consider the settlement agreement satisfactory: the intrastate rate; the refunds potentially due North Pole; the quality bank issue. Since appearing before the Committee on May 7th, 1982, Billig has conferred with representatives of British Petroleum Pipeline, who informed him they were unwilling to discuss refunds or the quality bank issue. Due to this fact, North Pole finds the settlement agreement contrary to the public interest, and Billig urged that the Legislature disapprove the agreement and bring pressure on FERC to get on with the case.

Jerry McCutcheon expressed opposition to the settlement agreement, saying that the State would suffer a net loss of revenue if it accepts the settlement agreement.

The meeting was adjourned at 8:20 p.m.

LAW OFFICES
BILLIG, SHER & JONES, P. C.

SUITE 300
2033 K STREET, N. W.
WASHINGTON, D. C. 20006

JACOB P. BILLIG
TERRENCE D. JONES
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The Honorable Rick Halford, Chairman
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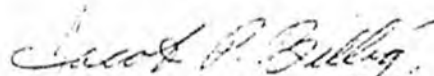
Dear Senator Fahrenkamph and Representative Halford:

In reference to the written summary which has been prepared of the May 7, 1982 TAPS Settlement Hearings, we would like to request that the additional two points, not set forth in the summary, be indicated since they were part of our presentation of the position of the North Pole Refinery:

1. The intrastate tariff rate from Pump Station #1 to North Pole should be adjusted in a manner so that the delivered cost of crude oil does not increase as a result of the settlement.
2. The Quality Bank litigation be resolved.

We would request that this clarification be included in the official summary of the hearing. For the record, I am attaching a written copy of the text of my May 7 presentation.

Very truly yours,



Jacob P. Billig
Counsel to North Pole Refinery

Enclosure

AGO 886277-1

MAY 7, 1982 STATEMENT OF JACOB P. BILLIG
ON BEHALF OF THE NORTH POLE REFINERY
TO THE ALASKA LEGISLATURE'S JOINT GAS PIPELINE COMMITTEE

We appear here today on behalf of North Pole Refinery which operates the only refinery in the Interior of Alaska at Fairbanks. As many of you are aware, this Refinery has been in operation since August of 1977. Since that time it has been furnishing refined products, including jet fuel, home heating oil and turbine fuel, to the citizens of the Interior of Alaska. In addition, the Refinery serves the outlying Bush areas and has recently begun selling jet fuel in the Anchorage market thus reducing the dependency of that market on West Coast carriers.

The ability of any interior Refinery to compete in these markets is, substantially dependent upon two interrelated factors:

- (a) the well head price of the oil; and
- (b) its TAPS tariff charges.

We are appearing here today because both of these factors are affected by its proposed settlement of the Trans Alaska Pipeline case pending in Washington before the Federal Energy Regulatory Commission. Before addressing the merits of the proposed settlement agreement, I should point out that the North Pole Refinery transportation costs, and in turn the cost to consumers in the Interior of Alaska, are directly impacted by a variety of tariff rates and charges assessed by the TAPS carriers. Thus, in addition to the tariff charge for the transportation of oil from Pump Station 1 to Valdez which the Refinery pays with respect to some 30,000 barrels per day, it also pays a transportation rate with regard to the movement of oil from Pump Station 1 to the North Pole Refinery at Fairbanks. In addition, the carriers have assessed a so-called Quality Bank charge on the North Pole return oil movements. This charge is currently at a rate of 15 cents per degree API or approximately \$2.10 per barrel of product. Under the methodology which the carriers have proposed, the Quality Bank charge could exceed \$5 a barrel.

Since 1977, the North Pole Refinery has been seeking in various litigations to secure reasonable rates and charges for its movements

from the TAPS carriers. To a certain degree it has been successful before the Alaska Pipeline Commission, predecessor to the APUC, in securing a mileage-based rate for the movements to North Pole. However, that rate is presently being challenged by the carriers in court. With regard to the rate to Valdez, there has been an initial decision by the FERC Administrative Law Judge, Judge Kane. The Quality Bank case is pending before the same judge. Thus, in neither case has there been any final resolution by the FERC.

The settlement agreement proposes to deal with only one aspect of North Pole's transportation charges -- the rate to be assessed for the Valdez movement. It does not seek to settle the controversies still outstanding with the TAPS carriers with respect to the intermediate point rate to North Pole or the Quality Bank charge. The fact that the proposed settlement addresses only a small part of its problems with the TAPS carriers is a major difficulty which the North Pole Refinery has with it.

Insofar as the Interior's interests are concerned, it is in any event clear that the effect of the proposed settlement upon the Refinery and its customers will be adverse. The Fairbanks rate is constructed as a percentage of the Valdez rates. An increase in the interstate Valdez rate thus would mean, if adopted for intrastate purposes as is likely, an increase in the intrastate Fairbanks rate. On the other hand, a decrease in the Valdez rate would also result in increased costs to the Interior since it would result in an increase in the well head price. In this respect, under the settlement which has been proposed, the cost per barrel of oil products will increase by \$1.37. This is a cost, unless there is a countervailing reduction in the intrastate Fairbanks rate, which would have to be borne by the consumers in the Interior of Alaska as well as in the Bush. It would also seriously disable efforts to supply needed fuels to the Anchorage market which are shipped on the Alaska Railroad.

Finally, the Refinery has difficulty with the proposed settlement because it fails to accord any refunds of tariff charges which have been paid by North Pole since the early part of 1978. As a public company with a duty to its stockholders as well as to its customers in maintaining a viable refinery operation, the North Pole Refinery cannot overlook these refunds.

The interests of the North Pole Refinery and the energy consumer in Alaska which I have described were initially not fully

Statement of Jacob P. Billig
May 7, 1982
Page 3

understood and taken into account in reaching the proposed settlement. We were pleased and gratified to hear today from the Attorney General that this will be rectified and that the issues I have outlined will be resolved as a condition to any acceptance of the settlement. Assuming that the rate and Quality Bank issues are resolved in a manner which meets Alaska energy needs, the North Pole Refinery will fully support the proposed settlement.

(In answer to a question from a member of the Committee, I clarified that North Pole's position is not that there must be higher rates to Valdez in order to serve its interests. I pointed out that while a lower rate to Valdez does disadvantage North Pole and the Interior in that it results in an increased well head price, we believed this could and should be handled by adjusting downward the intrastate rate to North Pole. In this respect, I noted that the movement of the "bottleneck" to a point south of the Refinery made it reasonable to accord such reduction.)

Jacob P. Billig

Fahrenkamp: First of all I will call the Executive Session in order.

Halford: Madam Chairman.

Fahrenkamp: Yes.

Halford: Before we - if we're going to have a taping, and if we do have things arrive transcript to the public and the press I would hope we do that - we could go through it and maybe if the Attorney General's office can go through it and just check to make sure that what is provided is not - prejudicial to our case but other than that I would provide the entire tape, less any of those sections at least a transcript of it.

Fahrenkamp: Well I - I think everybody knows how all of us feel about executive sessions - but there are times where I ---- use as much information as possible. So would you please proceed.

Loeffler: Number one if we don't finish we will be happy to come back even next week if necessary. Let's - let me divide that into three big issues - what we think is going to happen with this rate methodology question, which is really the big bucks question; second, what's going to happen with this so-called rate-

base, the arguments of waste and mismanagement; and third what the Department of Justice said to us this week

Number one, as I said openly [i.e. in open session], Kane's decision was based on depreciated original cost. That's something we've earned. Mr. Melvin says, "Oh I can't see any anything happening to the depreciated ~~original~~^{original} costs." There are four commissioners at the Commission. Three are republicans; one's a democrat. There's one democrat vacancy. On the general question, Williams case, as far as where the FERC will go on methodology, we know they are split between two choices, neither of which is what Mr. Melvin urges. These choices are the ICC valuation methodology and trended original cost.

It's no secret that companies have heard the same thing. It's been in the Trade Press. So, both of the alternatives for oil pipeline rate making generally are not the ones that the administrative law judge used for the Phase I interim decision or that Mr. Melvin bases his predictions on.

Representative Fred Brown:

Loeffler:

Levine:

Brown: :

Loeffler: - - - - -

Brown:

Fahrenkamp:

Loeffler: But there are also similar reports on the more general methodology in the Trade Press. So oil pipelines generally were seeing nothing like the law judge used. The bulk of those methodologies are a lot more favorable - to the industry.

Loeffler: Let me say one more sentence. You say -

Levine: The reason why is because then the rate base keeps shrinking so if you get say a 10% return or whatever your rate base, that is, your tariff, keeps going down. Under valuation its a combination, its partly depreciated original cost~~s~~ and partly replacement cost~~s~~, which obviously goes up in inflationary times. So there the rate base stays constant or goes up a little bit so your tariffs go up a little bit. Under trended original cost the methodology involves adjusting the rate base every year for the rate of inflation. Now, eventually the rate base does begin to shrink because your accumulated depreciation eats it up, but only after the first 15-20 years do you reach a tipping point. The tariffs go up considerably - can go up - let me put it this way, faster than the tariffs provided for in the settlement, because the settlement tariffs only go up at 40% the rate of inflation, they don't go up at 100% inflation.

Cotten: Madam Chairman, can we kind of try to constrain ourselves to the material that is suppose to be a secret or whatever?

Loeffler: Point number one: there are both public and nonpublic sources of information that suggest the commissioners are going away from us.

There is the deregulation movement in Congress and maybe Senator Stevens can block that for TAPS and maybe he can't.

Four years from now,
if you've got a new national administration that is very consumer-minded it might turn again. I can't - I'm just telling you what we know about the people who are on the Commission today.

In December, ^{the} one democrat on the Commission whom we thought was most favorable to our point of view and to the Judge's decision of law, came and gave a speech that was reported publicly saying that he wanted to go with one of these other formulas. It - it shook us up. That's number one.

Number two - the issue of waste and mismanagement: the Phase Two case. This one is currently being tried, there's no decision on it yet before the law judge. It's no secret the law judge doesn't like it. He said, walking out of the hearing room the other day, "I'm counting on the settlement to save me from this."

Special counsel Terry Lenzner has given us an estimate of what is the most he could win and what he believes is the likely result.

Halford:

Loeffler:

Levine:

Loeffler:

The third point, Department of Justice. Department of Justice staff, mainly Don Kaplan who has been on the case for five years as the litigation counsel

made arguments similar to the extreme position expressed in Dennis Melvin's letter. We did a lot of work responding to Kaplan's arguments. In fact, three weeks ago he said we might be violating the anti-trust laws, because we got our attorneys' fees back out of the settlement, it's a violation of the Elkins Act as a rebate or a dividend. In responding to the anti-trust problems and trying to get a fixed rate as far as the settlement, we - we've spent a lot of time doing a legal memo. We've locked in [Assistant U.S. Attorney General William] Baxter on Monday, He says,

I don't have any problem with the settlement except one - I want to know what happens in 1993. And all I need is a rate base number. I don't care what it is (within reasonable limits), so long as I can measure this rate of return for the whole project against it. The settlements is fine with me."

Now we're trying to satisfy the concerns of the Department of Justice by showing them on their own numbers that the rate of return on the investment over the life of the project will not exceed 8% real rate of return.

Again, you've got - I mean - I can make this sort of argument [i.e. the Melvin letter] just as well as Melvin has. It is the argument that we will make if we don't go ahead with the settlement.

But I don't want to be quoted publicly as saying,

We have finally!- I should have said this probably in the first place - the settlement has to be approved by the Commission. The standard is just and reasonable and in the public interest. Approval of the settlement is a public process in which everyone and their brother can make comments and object to the settlement. It goes up to the Commission and then it goes to the courts.

We have researched the law, there is a lot of law that says the value of certainty in a litigation that has been hotly contested makes sense in the public interest.

Parr: Maybe ^{now} they're answering the question I was trying to raise a while ago. We're ~~buying~~ ^{letting}, we've got ~~the~~ money on a horse, right?

Loeffler: That's right.

Parr: And your judgment is that we have bet enough money on that horse to go - to go to cop our bets and take - cut our losses and get out.

Loeffler: Right.

Parr: Is that what you're saying?

Loeffler: It's more like, "Quit while we're ahead." We're ahead, there's no question, we're ahead based on that law judge's decision. But several things have happened, interest rates have zoomed up - I mean he was talking about an 11.5 overall rate of return and now we see 15, 16, 17, and 18 coming out of the Commission. Even under his rate of return formula, that adjustment will occur automatically and increase the rates. What we fear, is that if we go to the Commission and we can ask them to decide it fast and maybe they will and maybe they won't - they are not going to take them judge's decision, but they are going to take something that's a lot less favorable to us.

On the part of the case that has not yet been decided, the Phase Two Cost Overrun, we've made a good case, there's no question of it.

Cotten: Well.

Fahrenkamp: Representative.

Cotten: Well, probably sounds like a real simple question, but don't those guys know it too. Doesn't BP know that it is sort of going the other way - you know - what makes them so anxious to settle.

Loeffler: Well it's the certainty. I mean I really think the interest isn't much different than us. They know, on the other hand, we can drag it out for a long time, depending upon whether the resources are committed to the case, I'm as good as the next fellow and so on - Terry Lenzner or John Cleary are both capable of stretching the case out. So they [the Pipeline Companies] live with uncertainty too.

Fahrenkamp: Are their further questions?

Cotten: Not just depreciated dollar thing you told me about earlier. Maybe I misunderstood something but, it is to the advantage to the pipeline owners to stretch it out, could they pay us off if they lose - depreciated dollars.

Loeffler: That's right.

Halford: It's to our advantage to settle now, cause we get the dollars at present dollars.

Loeffler: Who gets reduction.

Halford: Is that the point you were making a while ago?

Loeffler: Yes. We've - two things - we've got it now in the settlement agreement that the tariff drops. Right down to the

average rate is around \$6.00 that's being charged. It will drop as soon as the settlement is approved, I guess is their . . .

Levine: Immediately upon filing of the settlement, the tariff will drop to \$5.50. As soon as the settlement is approved the rate will drop still further to \$4.62.

Loeffler: Not - I don't want to overplay this because there are people who are going to oppose it, you can see that. Mr. Melvin - he can't take it to court. Department of Justice may decide to and they may decide not to. There are other people who can take it to court and if could be thrown out.

Unidentified legislator: I thought you said the Department of Justice . . . ?

Loeffler: They have one concern in that if we can meet their concern about having a rate base number or something that meets their standards might - after the settlement is over . . . The approach, like it or not, of everyone who has been involved in this is, "What's in it for me?" Department of Justice - well they spent a lot of time and money on this case so they want to get something out of it too. A ten-year settlement may be fine for the State of Alaska. The Department of Justice has weakened. Bill Baxter says, "After all," he says, "you give me a rate base number in 1993, and that's all I want."

Levine: We don't have it nailed down yet so that's why Mr. Loeffler conceded the possibility that the Department of Justice might challenge the settlement. Until we get that narrowed down.

Fahrenkamp: Representative Vaska.

Vaska: You - a couple of things you mentioned the federal antitrust division.

Fahrenkamp: Yeah.

Vaska: Now there use.

Loeffler: That's Department of Justice.

Vaska: Okay that's the Department of Justice.

Loeffler: They are a party to the case. Yeah, okay fine.

Vaska: And you said that they would take it away from the FERC?

Loeffler: The head of the antitrust division said he didn't believe the FERC would ever decide TAPS or Williams and that maybe ^{he} ought to find a way to take it away from them. None of us in the room knew what he meant. Legislation is the only obvious way to do that. There's not - you got to - its before the FERC by legislation - and it would take legislation to take it away.

Fahrenkamp: Representative Randolph.

Randolph: Charges moving with watch again, I don't think but I think its absolutely imperative that the folks - if we're going to stick with some of these time frame. Governor's original communication that these folks come back again next week and continue this.

Loeffler: You advise us and we'll come back.

Fahrenkamp: Okay, are there further questions before we go back into general - is that all you've got to say.

Levine: One small comment which I think is important. One of the things the staff of the legislature and Wilson and Mr. Melvin talked about in their memos is that there is nothing in the TAPS record that supports any methodology except valuation, which a lot of people think is nonsense, and original cost. That's right. And that means that one of the most likely things the Commission

ca do is to send the case back down to the Administrative Law Judge for a new round of hearings and evidence on these other methodologies. That adds three years onto all the estimates we've been giving you.

Fahrenkamp: Let me.

Loeffler: There are all sorts of ways to postpone a decision, especially for a bunch of people who don't want to make them.

Fahrenkamp: Are there any other questions in before we go back in general session. Is there anything else that they want to say. I think . . .

Loeffler: Let me look at my notes quickly.

Fahrenkamp: Because I think it is important there may be questions that we can't think of to ask right now that are should be brought out in the executive session. That -

Loeffler: There's one thing I want to say.

Fahrenkamp: Those in the executive session.

Loeffler:

Levine: The only rates on the table were 78-79 rates.

Loeffler: And then they dismissed those, they say that those were okay and then you got to come back in the next race. I mean it's not a very satisfactory process, but there's if the commission is predisposed not to face the hard issue then they take the easy out of saying the early rate was just and reasonable for various reasons - one might be because the state didn't prove its case well enough, or because the interest rates have changed and you look at it now and they look okay and you want any other number, And then you've got zero in the bank.

Parr: Ok no I guess the question comes back to me out not being an attorney you know but we're talking about 2 billion dollars, as far as I'm concerned belongs to the State of Alaska. And the costs by comparison of carrying this thing forward is obviously slight. So what you've got to do is figure

of carrying it forward against 3 billion let's say on one hand and the odds of success on the other. And that's what this gentleman can tell us in private

what are our chances of coming out on top of this thing. One in three - one in five.

Loeffler: I would say what we did - what we did was so-called decision tree analysis each outcome it wasn't a and I stick by those views but coming out on top for the what you call a 3 billion dollars off I would say there one in ten or less.

Brown: Okay, if there one in ten then how much will it cost.

What's the rule?

How much the litigation fees.

Yeah.

Boy you got about 15 million dollars.

Total cost of the case 35 million.

We spent

What do you tell them

23 billion, 35 million

Fahrenkamp: Representative Vaska.

Vaska: Thank you Madam Chairman. One more question. The affect of a settlement or a continued litigation on further development of oil and gas. Usually.

It doesn't touch - with comparatives.

Okay, what about all the other productions?

Loeffler: Our - I'll tell you what my feeling is, I feel that it helps in two respects. Number 1 Charged rate will drop this year \$1.60 or \$1.70 from what it is today. So new companies not those that
up

breaking rates for the next ten years to figure out after transportation how much they get. So I think that helps. Because you're following your transportation. Number 2 I have to think that most people will differ with that removing this sort of open sore between the State and oil companies is favorable towards resources that's my personal judgment.

Fahrenkamp: Are there any further questions. Any thing else you want to bring to us before we

Brown: Okay - one more thing. Just to try and follow this down. You said less than one in ten, 35 million dollars, is the 3 billion dollar figure a discounted figure a present dollar value.

Loeffler: It's 1.7 is the net present value.

Levine: But.

everything assuming it happens

Brown: At what interest rate?

Levine: 6.25%.

Stoller: That is \$1.7 billion, discounted at 8%, in 1982 dollars. We have that figure from Milt Barker who did them today.

Brown: High this would be lower, and that assumes 6.25 % interest on it.

Loeffler: We've argued for a higher rate on refunds, and in other areas the commission does apply a higher rate, but the rate that's applied in these ones are according to an established rule for oil pipelines is 6.25.

Unidentified legislator: But what if it takes ten years instead of five years?

Levine: Net present value will go down 40%.

Unidentified legislator: So we're down to 1 million dollars ten years from now is the probably

Levine: That's off the back of my head rule of 72 I don't know.

You could figure it out, it's not difficult.

Fahrenkamp: Representative Brown.

Brown: Chair I'm sorry to be acting like it's the end of a Friday and not going through the chair but you now if the odds are ten to one against us, but the investment is two to a hundred, and my daddy taught me that when the amount of money that's offered you in the table is the inverse of the odds you're going to improve your hand, your going to stay in, you don't fold your cards.

Loeffler: That depends on your approach

Brown: I just ran out here, you know, so.

Loeffler: I-ultimately you have to make the judgment, I mean I - it's not my judgment, I'm a hired gun as is any lawyer. I can give you my chances and my thoughts

Careful.

Loeffler: here getting that much money. slip, you are getting money under the settlement, I mean so it's not - I don't know what you do.

Brown: Two dollars will get us a hundred and the odds against us are ten to one again.

Loeffler: Two dollars may get you a hundred.

Brown: Well yeah, the may is in the odds that will get us two to one against us. Any poker player stays in.

Loeffler: But, it depends, I don't play poker so maybe that.

Fahrenkamp: Rep. Halford.

Halford: Yeah - let me just try and follow that - not by asking not to say you said the best is ten to one - for one thing, and if its a billion dollars ten years down the road, what does the settlement get us pending ten years down the road? a billion dollar difference between the settlement and is a billion dollar difference.

Loeffler: In 1982.

Halford: Right.

Loeffler: between the settlement today and winning everything in 1992. That's.

As is less than one out of ten.

Loeffler: Yeah.

Fahrenkamp: Representative.

Cotten: Of course, this discussion of various probabilities of getting money back doesn't mean too much, because you got to care for various tariffs through to 1992 those to so that's a pretty superficial way of looking at it.

Loeffler(?): You don't have all the numbers in front of you.

Levine: numbers

I think the methodology is overworked too. But that's what

Loeffler: Excuse me but I've got to really run.

Fahrenkamp: Any objections?

Condon: Do you want them back next week? I'll bring them back.



Alaska State Legislature

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

May 17, 1982

Wilson L. Condon
Attorney General
Department of Law
Pouch K
Juneau, AK 99811

Dear Wil:

The members of the House Special Gas Pipeline Committee and the Senate Resources Committee would like to thank you for your presentation on the TAPS settlement. Your attempted settlement of this long standing litigation is to be commended and certainly appreciated. Although a difficult decision, we do not believe that the state should proceed with the settlement.

We believe that the state should continue with the Phase I litigation in order to establish a methodology necessary for long term stability. Although the proposed settlement may be a reasonable compromise of the state monetary interests through this decade, we believe that it is only through litigation that we can establish a principle that may last through this century. The development of future North Slope reserves will be directly affected by pipeline tariffs. The present litigation is the best chance the state has of establishing a favorable methodology that will materially aid the development of these reserves. Although the matter is complex, it is our view that the policy of developing the future reserves of the state outweighs the present certainty of the revenues that the settlement would secure.

Even though we would not now accept a settlement of the Phase I issues, the committee would still consider a Phase II rate base deduction settlement as long as that consideration has no adverse impact on either the timing or the overall outcome of the Phase I tariff methodology decision.

Sincerely,

Rep. Rick Halford, Chairman
House Special Gas Pipeline Committee

Sen. Bettye Fahrenkamp, Chairman
Senate Resources Committee

RH/BF/ls

AGO 886307

ALASKA
STATE LEGISLATURE
MEMORANDUM

TO: File
FROM: Sandra Schubert
DATE: May 19, 1982
RE: Tape of TAPs Hearing - May 7, 1982

In the process of being duplicated, Tape I (5/7/82) broke. Although it has been spliced back together, a portion of the dialogue may have been inadvertently deleted.

AGD 886390