

***SYNOPSIS OF  
MEASURES  
RELATING TO  
OIL AND GAS  
REVENUE  
DISPUTES***

**Synopsis of Measures Relating to Oil and Gas Revenue Disputes  
(House Resources Committee 3/21/90)**

**HB 519 (Gruenberg):** The major provisions of this proposal:

- establish an Administrative Law Judge within the Department of Administration with Superior Court Judge status to hear outstanding oil tax and royalty disputes,
- raise interest rates on outstanding tax and royalty disputes to 20%.
- require companies to prepay disputed taxes and royalties in order to bid on oil and gas leases .

**HB 541 (Cotten):** To ensure that major settlement of the State's royalty and tax dispute are in the public interest, this measure requires the Commissioner of Natural Resources (royalty) or Revenue (tax) to conduct an independent review of the proposed settlement before settling any dispute involving amounts greater than \$10 million in a tax year five years or more prior to the current year. The review will specify objectives, indicate how these objectives are met and evaluate how the settlement affects other outstanding disputes. Additionally, there shall be a minimum of 14 days between the time the Commissioner receives a final settlement offer and the date s/he approves the settlement.

**HB 554 (Koponen):** AS 09.25.100 and AS 43.05.230 establish taxpayer confidentiality as one of approximately 100 statutory exceptions to Alaska's sunshine laws. This measure adds new subsections to both statutes allowing the Commissioner of Revenue to prepare and issue summaries of information relating to income and tax paid by a producer of oil or gas in Alaska. Disclosure is at the Commissioner's discretion and is not required.

**HB 572 (Resources):** This bill amends AS 42.06.140 to give the Department of Natural Resources (DNR), which is currently expanding its pipeline monitoring role, direct control of the inter-state pipeline tariff management. To make sure that revenue and environmental consequences of pipeline tariffs receive due weight, this measure requires DNR to coordinate its efforts closely with the Departments of Revenue, Environmental Conservation and Law.

**HB 573 (Resources):** This measure:

- allows disclosure of the names of corporations with an assessment balance larger than \$5 million for any tax year five or more years before the current date, and the amounts of the outstanding balances. However, the corporation is allowed one year from assessment to settle the claim before disclosure is permitted. Release of taxpayer information under statute currently applies only to delinquent taxes;
- requires escrow one-half of assessed tax balances larger than \$10 million for a tax year five years prior to the current year when the assessment is older than one year. (In other words, one-half of a 1985 tax year assessment, including interest, could be escrowed in 1990, if the assessment had been on the books for one year.)

**Synopsis of Measures Relating to Oil and Gas Revenue Disputes  
(House Resources Committee 3/21/90)**

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— raise interest rates on outstanding tax and royalty disputes to 20%.  
— require companies to prepay disputed taxes and royalties in order to bid on oil and gas leases .

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Establishes Administrative Law Judge for Oil Tax and Royalty Disputes (Secs. 1-3, 6-8 and 10-13)

These sections establish an Administrative Law Judge within the Department of Administration with Superior Court Judge status to hear outstanding oil tax and royalty disputes.

— [Principal Statute References: AS 44.21.480-492; AS 38.05; AS 43.05.]

Raises Interest Rates on Outstanding Royalty and Tax Amounts (Sections 4, 9)

To reduce possible corporate incentives to delay resolution of tax and royalty cases, this portion of the bill raises interest rates on outstanding tax and royalty disputes to 20%.

— [Statute Reference: AS 43.05.225; AS 38.05.145]

— [See Fineberg Report: recommendation #1 (Chapter II, p. 16)]

Prohibits Companies with Outstanding Tax Disputes from Bidding on Oil and Gas Leases (Sections 5)

To increase corporate incentives to speed resolution of tax and royalty cases, this portion of the bill requires companies to prepay disputed taxes and royalties in order to bid on oil and gas leases .

— [Statute Reference: AS 38.05.180(f)]

STATE OF ALASKA  
THE LEGISLATURE

POUCH Y STATE CAPITOL  
JUNEAU ALASKA 99811  
907 465 3800

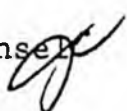
LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

March 9, 1990

SUBJECT: House Bill 519 - sectional analysis

TO: Representative Cliff Davidson, Co-Chair  
House Resources Committee

FROM: Jack Chenoweth  
Legislative Counsel 

The measure

-- makes substantial changes in the manner in which appeals of determinations of oil and gas-related taxes and royalty payments are addressed, principally through the establishment of an "office of administrative adjudication" that includes one "administrative law judge" and other personnel;

-- amends provisions generally applicable to royalty and tax payments, intended to foster or encourage an early tender of those payments to the state even if the party obligated to pay disputes the amount due;

-- sets limitations on what parties satisfy the criteria of a "qualified bidder" for purposes of obtaining future oil and gas leases involving state lands.

Bill section 1 establishes in the Department of Administration the "Office of Administrative Adjudication." The office is established and is to operate as follows:

AS 44.21.480 authorizes appointment of one administrative law judge and necessary assistants and clerical personnel, all of whom serve in the state's exempt service.

AS 44.21.483 sets out the qualifications necessary for a person to hold appointment as an administrative law judge.

AS 44.21.486 prescribes the manner of appointment of the administrative law judge. As with the appointment members of the judiciary, the judicial council is to screen

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March 9, 1990

applicants and the governor is to appoint from persons recommended from the position. The person appointed is subject to applicable laws governing conflict of interest. The section sets a term of eight years for the judge, authorizes the judge's reappointment, and indicates how the position is to be filled in the event of vacancy. The section also permits removal of the judge for cause, defines "cause," and sets out procedures applicable to a removal of a judge for cause.

AS 44.21.489 sets the compensation of the administrative law judge (equal to the salary of a superior court judge for Juneau).

AS 44.21.492 addresses the employment of other personnel by the office of administrative adjudication, and prescribes the benefits they are due. The section authorizes issuance of contracts for other personnel.

The duties of the office of administrative adjudication are set out in AS 44.21.495. Essentially, the statute contemplates that the office would adopt necessary procedural regulations, and thereafter hear and determine proceedings involving taxes, insofar as authorized by AS 43.05.285, and oil and gas royalty payments, insofar as authorized by AS 38.05.880.

The powers necessary for an administrative law judge to fulfill duties prescribed are set out in AS 44.21.498. Enforcement of powers through order of the superior court is contemplated.

Bill section 2 authorizes direct appeals of final tax and royalty decisions of the administrative law judge to the state supreme court.

Bill section 7 adds the administrative law judge and the office of administrative adjudication to the state's exempt service.

Bill section 8 adds the administrative law judge to the long list of state officials who are covered by the state's conflict of interest law.

\*

Representative Cliff Davidson  
Page 3  
March 9, 1990

The amendments and additions made by bill sections 3 - 6 clarify the handling of royalty payments due the state.

Bill section 6, establishing a new section, AS 38.05.880, creates a right in a person aggrieved by a determination of the Department of Natural Resources in fixing a state oil or gas royalty payment to challenge that determination before the office of administrative adjudication. The same section authorizes a trial de novo of that challenge under applicable procedures of the office of administrative adjudication.

Bill section 3 excepts the handling of oil and gas royalty challenges under AS 38.05.880 from the administrative appeal decisions of royalty determinations routinely appealable to the department commissioner.

The changes made by bill section 4 serve to clarify and to tighten the collection of the royalty and any penalty and interest on a range of state resources.

The amendment made by bill section 5 sets out a definition of "qualified bidder" for purposes of eligibility to bid and obtain future state oil and gas leases. In essence, a bidder is qualified if the bidder has remitted payment of all related taxes due the state, whether or not those payments are subject to dispute.

\*

The amendments and additions made by bill sections 9 - 13 clarify tax collection practices of the state in substantially the same manner as set out above for royalties.

Bill section 13, establishing a new section, AS 43.05.285, directs separate procedures for appeals of taxes, penalties, and interest under the corporate income and oil-industry-related levies. As with the treatment of royalties discussed above with reference to bill section 6, those appeals would be referred to the office of administrative adjudication for trial de novo.

The amendments made to bill sections 10, 11, and 12 incorporate changes made necessary by the addition of AS 43.05.285 in bill section 13. Sections 10 and 11 also incorporate technical additions to cover the denial of a request for a refund.

Representative Cliff Davidson  
Page 4  
March 9, 1990

Bill section 9 increases to 20 percent (from the general rate of 12 percent) the interest rate on delinquent taxes related to levy on oil-producing properties and income if the levy exceeds \$100,000.

\*

The remaining section of the bill, bill section 14, indicates the manner in which royalty and tax grievances in effect on the effective date of the Act are to be transitionally handled.

JBC:lmb  
L10/005

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_ Agency Affected: Department of Administration  
 Title: An Act relating to collection BRU: Office of Administrative Adjudication  
and payment of certain State taxes\*  
 Sponsor: Gruenberg Components: \_\_\_\_\_  
 Requestor: \_\_\_\_\_

\* and royalties from State revenues  
 EXPENDITURES/REVENUES: (Thousands of Dollars)

| OPERATING         | FY 91 | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|-------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES | 275.1 | 289.2 | 294.1 | 299.5 | 305.2 | 311.3 |
| TRAVEL            | 25.0  | 25.8  | 26.5  | 27.3  | 28.1  | 29.0  |
| CONTRACTUAL       | 159.8 | 164.5 | 169.3 | 174.4 | 179.5 | 184.8 |
| SUPPLIES          | 6.0   | 4.1   | 4.2   | 4.4   | 4.5   | 4.6   |
| EQUIPMENT         | 47.9  | 0     | 0     | 0     | 0     | 0     |
| LAND & STRUCTURES |       |       |       |       |       |       |
| GRANTS, CLAIMS    |       |       |       |       |       |       |
| MISCELLANEOUS     |       |       |       |       |       |       |
| TOTAL OPERATING   | 511.8 | 483.6 | 494.1 | 505.6 | 517.3 | 529.7 |
| CAPITAL           |       |       |       |       |       |       |
| REVENUE           |       |       |       |       |       |       |

FUNDING: (Thousands of Dollars)

|               |       |       |       |       |       |       |
|---------------|-------|-------|-------|-------|-------|-------|
| GENERAL FUND  | 511.8 | 483.6 | 494.1 | 505.6 | 517.3 | 529.7 |
| FEDERAL FUNDS |       |       |       |       |       |       |
| OTHER         |       |       |       |       |       |       |
| TOTAL         | 511.8 | 483.6 | 494.1 | 505.6 | 517.3 | 529.7 |

POSITIONS:

|           |   |   |   |   |   |   |
|-----------|---|---|---|---|---|---|
| FULL-TIME | 5 | 5 | 5 | 5 | 5 | 5 |
| PART-TIME |   |   |   |   |   |   |
| TEMPORARY |   |   |   |   |   |   |

ANALYSIS: (Attach a separate page if necessary)

It is assumed the office will be located in Juneau.

Due to the complexities of the legislation it is not possible to accurately assess the cost of the "Office of Administrative Adjudication." The exact number of staff needed is unknown but it is estimated that a four-person office would be required as well as a full-time accounting

(CONTINUED)

Prepared by: Mike Maher *Mike Maher* Phone: 465-2277  
 Division: Administrative Services Date: 03-21-90  
 Approved by Commissioner: Frank S. Baxter *Frank S. Baxter* Date: 3/21/90  
 Agency: Department of Administration

Distribution (by preparer):  
 Legislative Finance  
 Legislative Sponsor  
 Requestor  
 Office of Management and Budget  
 Impacted Agency(ies)

clerk position to be located within the Division of Administrative Services. For purposes of analysis the specific positions required would be: one Judge, salary range 28E (set by statute); one Law Clerk, salary range 21A; one Secretary II, salary range 12B; one Clerk III, salary range 8B, one Accounting Clerk III, salary range 10B. It is also anticipated that specialized personnel may be required and would be contracted for on an as needed basis. It is further assumed that office space outside of existing office space (in the State Office Building) will be required, configured to the specialized needs of this office. The office will also require computer support as well as the purchase of a sophisticated recording system for hearings.

The office would require budgetary, accounting, contracting, and word processing support which will be provided by the Division of Administrative Services at additional cost.

Travel costs are unknown at this time but it is estimated that research, etc., will involve substantial cost.

One time costs for equipment include the purchase of a telephone system, a facsimile machine, office furniture, computer and recording equipment.

Some of these services and costs may be a duplication of costs and functions already being performed by the Department of Revenue and other departments, but until further meetings with these departments take place, these costs cannot be extrapolated.

This fiscal note assumes a 3 percent annual escalation factor for additional costs and cost increases due to inflation.

**FISCAL NOTE**

**REQUEST:**

Revision Date: \_\_\_\_\_  
Title: "An Act relating to... state taxes and royalties from state resources."  
Sponsor: Repr. Gruenberg  
Requestor: House Resources

Agency Affected: Department of Law  
BRU: Oil and Gas Special Projects  
Components: Operations

**EXPENDITURES/REVENUES: (Thousands of Dollars)**

| OPERATING              | FY 91      | FY 92      | FY 93      | FY 94      | FY 95      | FY 96      |
|------------------------|------------|------------|------------|------------|------------|------------|
| PERSONAL SERVICES      |            |            |            |            |            |            |
| TRAVEL                 |            |            |            |            |            |            |
| CONTRACTUAL            |            |            |            |            |            |            |
| SUPPLIES               |            |            |            |            |            |            |
| EQUIPMENT              |            |            |            |            |            |            |
| LAND & STRUCTURES      |            |            |            |            |            |            |
| GRANTS, CLAIMS         |            |            |            |            |            |            |
| MISCELLANEOUS          |            |            |            |            |            |            |
| <b>TOTAL OPERATING</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> |

|         |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|
| CAPITAL |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|

|         |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|
| REVENUE |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|

**FUNDING: (Thousands of Dollars)**

|               |     |     |     |     |     |     |
|---------------|-----|-----|-----|-----|-----|-----|
| GENERAL FUND  | -0- | -0- | -0- | -0- | -0- | -0- |
| FEDERAL FUNDS |     |     |     |     |     |     |
| OTHER         |     |     |     |     |     |     |
| <b>TOTAL</b>  |     |     |     |     |     |     |

**POSITIONS:**

|           |     |     |     |     |     |     |
|-----------|-----|-----|-----|-----|-----|-----|
| FULL-TIME | -0- | -0- | -0- | -0- | -0- | -0- |
| PART-TIME |     |     |     |     |     |     |
| TEMPORARY |     |     |     |     |     |     |

**ANALYSIS : (Attach a separate page if necessary)**

Please see the attached analysis.

Prepared by: Richard I. Pegues, Director Phone: 465-3672  
 Division: Administrative Services Date: March 20, 1990  
 Approved by Commissioner: Douglas B. Baily, Attorney General Date: March 20, 1990  
 Agency: Department of Law

Distribution (by preparer):  
 Legislative Finance  
 Legislative Sponsor  
 Requestor  
 Office of Management and Budget  
 Impacted Agency(ies)

# CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HB 519

This bill amends AS 44.21 to establish an office of administrative adjudication within the Department of Administration. The new office would hear and determine proceedings involving the levy and collection of oil and gas taxes, and involving payment to the state of oil and gas royalty payments. Currently, oil and gas tax cases are heard by hearing officers within the Department of Revenue, and oil and gas royalty disputes are heard in the superior court. Consequently, the bill would have the effect of changing the forum in which these cases are heard.

The bill also amends AS 38.05.180(f) to provide that a person is not a qualified bidder, for state oil and gas leases, unless the person has paid to the state all taxes assessed under AS 43.55, AS 43.56, AS 43.57, and former AS 43.21 and all royalties due under AS 38.05, whether or not the person disputes the tax assessment or determinations of the amount of royalty due.

The Department of Law already represents the Department of Revenue and the Department of Natural Resources in legal proceedings that arise from oil and gas tax and oil and gas royalty disputes, as provided by AS 44.23.020. Although there may be some additional cost, because of the time it may take for a new adjudicative staff to become familiar with these highly complex cases, this cost cannot be determined at this time.

If a transition to the proposed office of administrative adjudication is trouble-free, any cost could be borne by reallocating existing resources. However, if the transition is not smooth, there could be considerable delay resulting in higher costs. There is simply no way for the Department of Law to accurately predict the outcome of such an event and, as a consequence, we have not requested fiscal note costs.

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_  
Title: An act relating to collection & payment of State taxes & royalties.  
Sponsor: Sruenders, Koonen, Ellis  
Requestor: \_\_\_\_\_

Agency Affected: \_\_\_\_\_  
BRU: \_\_\_\_\_  
Components: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

| OPERATING         | FY 91         | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|-------------------|---------------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES |               |       |       |       |       |       |
| TRAVEL            |               |       |       |       |       |       |
| CONTRACTUAL       |               |       |       |       |       |       |
| SUPPLIES          |               |       |       |       |       |       |
| EQUIPMENT         |               |       |       |       |       |       |
| LAND & STRUCTURES |               |       |       |       |       |       |
| GRANTS, CLAIMS    |               |       |       |       |       |       |
| MISCELLANEOUS     |               |       |       |       |       |       |
| TOTAL OPERATING   |               |       |       |       |       |       |
| CAPITAL           |               |       |       |       |       |       |
| REVENUE           | See analysis. |       |       |       |       |       |

FUNDING: (Thousands of Dollars)

|               |  |  |  |  |  |  |
|---------------|--|--|--|--|--|--|
| GENERAL FUND  |  |  |  |  |  |  |
| FEDERAL FUNDS |  |  |  |  |  |  |
| OTHER         |  |  |  |  |  |  |
| TOTAL         |  |  |  |  |  |  |

POSITIONS:

|           |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|
| FULL-TIME |  |  |  |  |  |  |
| PART-TIME |  |  |  |  |  |  |
| TEMPORARY |  |  |  |  |  |  |

ANALYSIS : (Attach a separate page if necessary)

See attached.

Prepared by: Charles L. Loosdon  
Division: Oil and Gas Audit  
Approved by Commissioner: [Signature]  
Agency: \_\_\_\_\_

Phone: 277-5627  
Date: March 22, 1990  
Date: 3/26/90

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)

Fiscal Note  
HB 519,  
March 22, 199

### Analysis

This bill would establish an office of administrative adjudication comprised of an administrative law judge and support staff. Various administrative procedures are discussed in the bill. The bill also contains two provisions which will have revenue consequences for the State.

The first revenue impacting provision is one which establishes an interest penalty of 20% per year for underpayment of royalties and oil and gas taxes. This provision could work to the disadvantage of the State in the event of overpayment since the State is restricted to less risky investments i.e. we would be guaranteeing above market rates of interest on overpayment amounts assuming that interest rates remain in their current range.

The second revenue impacting provision restricts the ability of firms to bid in State oil and gas lease sales if they have outstanding royalty assessments. The effect of this restriction could be to reduce the number of potential lease bidders and reduce the expected price of the leases. Qualified purchasers could in fact capture the State's lost value by reselling the leases to those firms excluded from the original sale.

Internal Independent Settlement Review Procedures for Royalty Settlements (Section 1)

To ensure that any major settlement of the State's royalty litigation is in the public interest -- and to assure the public that this is the case -- this measure requires the Commissioner of Natural Resources, before settling any dispute involving amounts greater than \$10 million in a tax year five years or more prior to the current year, to conduct an independent review of the proposed settlement.

The review will specify objectives, indicate how these objectives are met and evaluate how the settlement affects other outstanding disputes. Additionally, there shall be a minimum of 14 days between the time the Commissioner receives a final settlement offer and the date s/he approves the settlement.

With settlement offers increasingly likely as trial date approaches, there are no procedures in place to ensure that settlement review will be thorough and deliberate.

— [Statute Reference: AS 38.05.035]

— [See Fineberg Report: Recommendation #8, pp. 23-24]

Tax Settlement Internal Independent Review Procedures (Sections 2-4)

The remaining three sections of HB 541 contain language similar to Section 1 for insertion at three places in the tax statutes:

Sec. 2: Adds new subsections to AS 43.05.060 (on closing agreements) requiring settlement review for settlements over \$10,000,000.

Sec. 3: Adds new subsections to AS 43.05.070 (on compromises) requiring settlement review for settlements over \$10,000,000.

Sec. 4: Adds new subsections to AS 43.05.260 (on assessment revisions) requiring settlement review in settlements over \$10,000,000.

— [Statute Reference: AS 43.05.060, .070, .260]

— [See Fineberg Report : Recommendation #15 (pp. 30-31)]

STATE OF ALASKA  
THE LEGISLATURE

POUCH Y STATE CAPITOL  
JUNEAU ALASKA 99811  
907 465 3800


LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

March 9, 1990

SUBJECT: House Bill 541 -- sectional analysis

TO: Representative Cliff Davidson, Co-Chair  
House Resources Committee

FROM: Jack Chenoweth  
Legislative Counsel 

The measure sets out statutory guidelines applicable to the handling and disposition of agreements, compromises, and settlements relating to certain royalty and net profit payments payable under AS 38.05 and to certain tax disputes arising under AS 43.

The handling of royalty and net profit payments involving claims totalling, with applicable penalty and interest, \$10,000,000 or more, is addressed by the new subsection added to AS 38.05.035 by bill section 1. In that change:

- at the time the Department of Natural Resources commenced negotiations with an eye toward compromise or settlement, the department would be required, within 14 days, to advise the commissioner of revenue and the attorney general;
- while negotiations were in progress, the commissioner of natural resources would be required to give notice to the other two state officers at least every 30 days;
- the commissioner of natural resources would not be permitted to enter into a compromise or settlement agreement unless (1) the commissioner first obtained and reviewed an independent appraisal of the effects of the proposed compromise or settlement, and (2) unless 14 days passed between the commissioner's receipt of the proposed compromise or settlement agreement and the date of the commissioner's execution of the proposed agreement.

Representative Cliff Davidson  
Page 2  
March 9, 1990

The bill also contains [page 1, line 27 - page 2, line 9] provisions indicating who may prepare the required independent appraisal of the proposed compromise or settlement and what that appraisal must contain.

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Substantially similar procedures, time limitations, and guidelines would apply to tax settlements under the additions made by bill sections 2 - 4. In those instances, negotiations would be undertaken by the commissioner of revenue, who must regularly advise the commissioner of natural resources and the attorney general. Otherwise, the same general parameters and limitations attach to tax disputes as are described above for resolutions involving royalties and net profit payments.

In these sections,

-- the additional materials added by bill section 2 address negotiations to resolve a tax dispute by means of agreements respecting the taxpayer's tax liability;

-- the additional materials added by bill section 3 involve the authority of the Department of Revenue to compromise a tax or penalty in the event of doubt as to the taxpayer's tax liability; and

-- the additional materials added by bill section 4 are incorporated to govern redeterminations or revisions of tax liability (i.e. redetermination of tax liability through department-initiated tax assessment ).

JBC:lmb  
L10/006

**FISCAL NOTE**

**REQUEST:**

Revision Date: \_\_\_\_\_  
Title: "An Act relating to... agreements, compromises... Natural Resources and Revenue."  
Sponsor: Repr. Cotten  
Requestor: House Resources

Agency Affected: Department of Law  
BRU: Oil and Gas Special Projects  
Components: Operations

**EXPENDITURES/REVENUES: (Thousands of Dollars)**

| OPERATING              | FY 91 | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|------------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES      |       |       |       |       |       |       |
| TRAVEL                 |       |       |       |       |       |       |
| CONTRACTUAL            |       |       |       |       |       |       |
| SUPPLIES               |       |       |       |       |       |       |
| EQUIPMENT              |       |       |       |       |       |       |
| LAND & STRUCTURES      |       |       |       |       |       |       |
| GRANTS, CLAIMS         |       |       |       |       |       |       |
| MISCELLANEOUS          |       |       |       |       |       |       |
| <b>TOTAL OPERATING</b> | -0-   | -0-   | -0-   | -0-   | -0-   | -0-   |

|         |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|
| CAPITAL |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|

|         |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|
| REVENUE |  |  |  |  |  |  |
|---------|--|--|--|--|--|--|

**FUNDING: (Thousands of Dollars)**

|               |     |     |     |     |     |     |
|---------------|-----|-----|-----|-----|-----|-----|
| GENERAL FUND  | -0- | -0- | -0- | -0- | -0- | -0- |
| FEDERAL FUNDS |     |     |     |     |     |     |
| OTHER         |     |     |     |     |     |     |
| <b>TOTAL</b>  |     |     |     |     |     |     |

**POSITIONS:**

|           |     |     |     |     |     |     |
|-----------|-----|-----|-----|-----|-----|-----|
| FULL-TIME | -0- | -0- | -0- | -0- | -0- | -0- |
| PART-TIME |     |     |     |     |     |     |
| TEMPORARY |     |     |     |     |     |     |

**ANALYSIS : (Attach a separate page if necessary)**

Please see the attached analysis.

Prepared by: Richard I. Pegues, Director Phone: 465-3672  
Division: Administrative Services Date: March 21, 1990  
Approved by Commissioner: Richard I. Pegues / FUR / Douglas B. Baily, Attorney General Date: March 21, 1990  
Agency: Department of Law

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)

# CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HB 541

This bill amends AS 38.05.035 to require that if the commissioner of natural resources enters into negotiations to compromise or settle a dispute between the department and a person as to a royalty or net profit payment involving a claim that totals, with applicable penalty and interest, \$10,000,000 or more, the commissioner shall advise the commissioner of revenue and the attorney general that negotiations have commenced, not later than 14 days after the commencement of negotiations.

This bill also amends AS 43.05.070 to require that if the Department of Revenue enters into negotiations to compromise or settle a tax dispute between the department and a taxpayer involving a claim that totals, with applicable penalty and interest, \$10,000,000 or more, the commissioner of revenue shall advise the commissioner of natural resources and the attorney general that negotiations have commenced, not later than 14 days after the negotiations commenced.

In effect, the bill institutionalizes the notification process to be followed whenever the Departments of Natural Resources or Revenue seek to settle major royalty or tax claims. Inasmuch as notification is a normal part of business, there should not be a fiscal impact for the Department of Law.

**FISCAL NOTE**

**REQUEST:**

Revision Date: \_\_\_\_\_  
Title: An Act relating to certain  
agreements & settlements by DNR & DOR  
Sponsor: Cotten, Navarre  
Requester: \_\_\_\_\_

Agency Affected: \_\_\_\_\_  
BRU: \_\_\_\_\_  
Components: \_\_\_\_\_

**EXPENDITURES/REVENUES: (Thousands of Dollars)**

| OPERATING         | FY 91         | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|-------------------|---------------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES |               |       |       |       |       |       |
| TRAVEL            |               |       |       |       |       |       |
| CONTRACTUAL       |               |       |       |       |       |       |
| SUPPLIES          |               |       |       |       |       |       |
| EQUIPMENT         |               |       |       |       |       |       |
| LAND & STRUCTURES |               |       |       |       |       |       |
| GRANTS, CLAIMS    |               |       |       |       |       |       |
| MISCELLANEOUS     |               |       |       |       |       |       |
| TOTAL OPERATING   |               |       |       |       |       |       |
| CAPITAL           |               |       |       |       |       |       |
| REVENUE           | See analysis. |       |       |       |       |       |

**FUNDING: (Thousands of Dollars)**

|               |  |  |  |  |  |  |
|---------------|--|--|--|--|--|--|
| GENERAL FUND  |  |  |  |  |  |  |
| FEDERAL FUNDS |  |  |  |  |  |  |
| OTHER         |  |  |  |  |  |  |
| TOTAL         |  |  |  |  |  |  |

**POSITIONS:**

|           |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|
| FULL-TIME |  |  |  |  |  |  |
| PART-TIME |  |  |  |  |  |  |
| TEMPORARY |  |  |  |  |  |  |

**ANALYSIS:** (Attach a separate page if necessary)

See attached.

Prepared by: Charles I. Longdon  
Division: Oil and Gas Audit

Phone: 277-5627  
Date: March 22, 1990

Approved by Commissioner: [Signature]  
Agency: \_\_\_\_\_

Date: 3/26/90

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requester  
Office of Management and Budget  
Impacted Agency(ies)

Fiscal Note  
HB 541  
March 22, 199

#### Analysis

This bill would establish a review and or a 14 day cooling off period for agreements and settlements of tax and royalty disputes in excess of \$10 million entered into by the Department of Revenue or the Department of Resources.

The aim of this bill is to provide additional assurance that the State receives the maximum expected value from oil and gas tax and royalty revenue.

## HB 573

### Assessment Total Disclosure (Secs. 1, 2, 4):

Release of taxpayer information under statute currently applies only to delinquent taxes. HB 573 permits disclosure of (1) the names of corporations with an assessment balance larger than \$5 million for any tax year five or more years before the current date, and (2) the amounts of the outstanding balances. However, the corporation is allowed one year from assessment to settle the claim before disclosure is permitted.

Sections 1 and 2 contain legislative findings and purpose; section 4 adds a new AS 43.05.230(e).

— [Statute Reference: AS 43.05.230(e)]

— [See Fineberg Report, Recommendation #3 (Chapter 2, pp. 18-19)]

### 50% Escrow Requirement for Large Aging Assessments Secs. 3, 5, 6:

To reduce possible corporate incentive to delay tax payments in order to retain the funds, this legislation would escrow one-half of assessed tax balances larger than \$10 million for a tax year five years prior to the current year when the assessment is older than one year. (In other words, one-half of a 1985 tax year assessment, including interest, could be escrowed in 1990, if the assessment had been on the books for one year.)

The escrow proposal might be subject to challenge as confiscatory and arbitrary. Under the circumstances specified here, however, escrow does not seem arbitrary. This provision: (1) applies only to assessment amounts larger than \$10 million; (2) does not apply to individuals, but only to corporations; and (3) does not apply to any tax paid within five years of the tax year in question. Additionally, it should be noted that the State is not seeking the funds directly, but merely to have those funds escrowed to reduce corporate incentives to delay payment.

— [Statute Reference: AS 43.05.240 (and new AS 43.05.100)]

— [See Fineberg Report, Recommendation #2 (Chapter 2, pp. 17-18)]

STATE OF ALASKA  
THE LEGISLATURE

POUCHY STATE CAPITOL  
JUNEAU ALASKA 99811  
907 465 3800


LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M

March 9, 1990

SUBJECT: House Bill 573 - sectional analysis

TO: Representative Cliff Davidson, Co-Chair  
House Resources Committee

FROM: Jack Chenoweth  
Legislative Counsel 

To assist in the collection of delinquent tax payments claimed by the state, the measure makes amendments to state laws applicable to the Department of Revenue's procedures for collection of revenue from certain taxpayers, and authorizes public disclosure by the department of information about the taxes payable by certain corporate taxpayers.

Bill sections 1 and 2 enunciate statements of findings and purposes applicable to the measure.

The addition of AS 43.05.100(c) by bill section 3 explicitly authorizes the commissioner of revenue to engage the services of banks located in the state to perform escrow services for tax payments received by the department under AS 43.05.240(e), added in the measure by bill section 6. The escrow arrangement is intended to serve as a mechanism for collection and handling certain tax revenue that is in dispute. The provision describes the essential mechanics of entering into escrow agreements, the deposit of money into the account(s) established, and the release of money on the occurrence of any of several contingencies.

If the department determines in an assessment that, for any year that is five or more years earlier, the taxpayer owes \$10,000,000 in taxes, penalties, and interest, bill section 6 directs the taxpayer to remit payment of at least one-half the amount assessed. The amount is to be remitted within one year of the taxpayer's receiving the assessment, and the deposit is a requisite to the taxpayer's opportunity for obtaining a hearing under existing provisions of the

Representative Cliff Davidson  
Page 2  
March 9, 1990

section. It is that payment that is to be made the subject of an escrow deposit under bill section 3.

The amendment made by bill section 5 addresses the taxpayer's opportunity for a hearing by directing that payment of the amount required by AS 43.05.240(b), if any, to the department for deposit into the escrow account is a requisite to securing a formal hearing to review the department's tax assessment.

Bill section 4 addresses a related situation. The principal amendment made in that section [page 3, lines 17 - 24] makes another exception to the current law governing non-disclosure of tax return information. It would permit the department to disclose information as to assessments made by the department against corporate taxpayers for tax years that are at least five years old if the amount of assessment exceeds \$5,000,000 and at least one year has passed since the department served its notice of assessment and demand for payment.

JBC:lmb  
L10/009

## FISCAL NOTE

**REQUEST:**

Revision Date: \_\_\_\_\_  
 Title: "...relating to assessment, collection  
 and payment of taxes..."  
 Sponsor: House Resources  
 Requestor: House Resources

Agency Affected: Department of Law  
 BRU: Oil and Gas Special Projects  
 Components: Operations

**EXPENDITURES/REVENUES:** (Thousands of Dollars)

| OPERATING              | FY 91 | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|------------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES      |       |       |       |       |       |       |
| TRAVEL                 |       |       |       |       |       |       |
| CONTRACTUAL            |       |       |       |       |       |       |
| SUPPLIES               |       |       |       |       |       |       |
| EQUIPMENT              |       |       |       |       |       |       |
| LAND & STRUCTURES      |       |       |       |       |       |       |
| GRANTS, CLAIMS         |       |       |       |       |       |       |
| MISCELLANEOUS          |       |       |       |       |       |       |
| <b>TOTAL OPERATING</b> | -0-   | -0-   | -0-   | -0-   | -0-   | -0-   |
| <b>CAPITAL</b>         |       |       |       |       |       |       |
| <b>REVENUE</b>         |       |       |       |       |       |       |

**FUNDING:** (Thousands of Dollars)

|               |     |     |     |     |     |     |
|---------------|-----|-----|-----|-----|-----|-----|
| GENERAL FUND  | -0- | -0- | -0- | -0- | -0- | -0- |
| FEDERAL FUNDS |     |     |     |     |     |     |
| OTHER         |     |     |     |     |     |     |
| <b>TOTAL</b>  |     |     |     |     |     |     |

**POSITIONS:**

|           |     |     |     |     |     |     |
|-----------|-----|-----|-----|-----|-----|-----|
| FULL-TIME | -0- | -0- | -0- | -0- | -0- | -0- |
| PART-TIME |     |     |     |     |     |     |
| TEMPORARY |     |     |     |     |     |     |

**ANALYSIS :** (Attach a separate page if necessary)

Please see the attached analysis.

Prepared by: Richard I. Pegues, Director Phone: 465-3672  
 Division: Administrative Services Date: March 21, 1990  
 Approved by Commissioner: Richard I. Pegues / FOR /  
 Approved by Commissioner: Douglas B. Baily, Attorney General Date: March 21, 1990  
 Agency: Department of Law

Distribution (by preparer):  
 Legislative Finance  
 Legislative Sponsor  
 Requestor  
 Office of Management and Budget  
 Impacted Agency(ies)

# CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HB 573

This bill amends AS 43.05 in two important respects. First, it changes AS 43.05.230(e) to allow the commissioner of revenue to publish the amount of an assessment made by the Department of Revenue against a corporate taxpayer relating to a tax year that is five or more years before the year in which it is made. Such publication could take place if the amount of the assessment is more than \$5,000,000, and if at least one year has passed since the department served notice of assessment and a demand for payment under AS 43.05.245.

Second, the bill amends AS 43.05.240 to provide that a person aggrieved by the action of the Department of Revenue in fixing the amount of a tax or imposing a penalty may request a hearing on the matter, but in certain cases the person must pay a part of the amount imposed, before a hearing would be granted. In these cases the taxpayer would be required to pay at least one-half of the amount of the assessment within one year after the department serves notice of assessment and a demand for payment under AS 43.05.245, if the tax year is five or more years before the year in which the amount of tax is fixed and if the total amount of the assessment exceeds \$10,000,000. Current statute does not require a partial payment of an assessment before an aggrieved taxpayer initiates the hearing process.

In any event, the Department of Law would continue to represent the Department of Revenue's audit staff in bringing tax collection cases, whether or not a partial payment requirement is involved. Consequently, there will not be a fiscal impact for the Department of Law.

## FISCAL NOTE

**REQUEST:**

Revision Date: \_\_\_\_\_ Agency Affected: \_\_\_\_\_  
 Title: An act relating to the assessment BRU: \_\_\_\_\_  
collection & payment of taxes and other  
 Sponsor: Resources Committee matters Components: \_\_\_\_\_  
 Requestor: \_\_\_\_\_

**EXPENDITURES/REVENUES:** (Thousands of Dollars)

| OPERATING              | FY 91         | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 |
|------------------------|---------------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES      |               |       |       |       |       |       |
| TRAVEL                 |               |       |       |       |       |       |
| CONTRACTUAL            |               |       |       |       |       |       |
| SUPPLIES               |               |       |       |       |       |       |
| EQUIPMENT              |               |       |       |       |       |       |
| LAND & STRUCTURES      |               |       |       |       |       |       |
| GRANTS, CLAIMS         |               |       |       |       |       |       |
| MISCELLANEOUS          |               |       |       |       |       |       |
| <b>TOTAL OPERATING</b> |               |       |       |       |       |       |
| <b>CAPITAL</b>         |               |       |       |       |       |       |
| <b>REVENUE</b>         | See analysis. |       |       |       |       |       |

**FUNDING:** (Thousands of Dollars)

|               |  |  |  |  |  |  |
|---------------|--|--|--|--|--|--|
| GENERAL FUND  |  |  |  |  |  |  |
| FEDERAL FUNDS |  |  |  |  |  |  |
| OTHER         |  |  |  |  |  |  |
| <b>TOTAL</b>  |  |  |  |  |  |  |

**POSITIONS:**

|           |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|
| FULL-TIME |  |  |  |  |  |  |
| PART-TIME |  |  |  |  |  |  |
| TEMPORARY |  |  |  |  |  |  |

**ANALYSIS :** (Attach a separate page if necessary)

See attached.

Prepared by: Charles L. Loosdon Phone: 277-5627  
 Division: Oil and Gas Audit Date: March 22, 1990

Approved by Commissioner: *[Signature]* Date: 3/26/90  
 Agency: \_\_\_\_\_

Distribution (by preparer):  
 Legislative Finance  
 Legislative Sponsor  
 Requestor  
 Office of Management and Budget  
 Impacted Agency(ies)

Fiscal Note  
HB 573  
March 23, 1990

### Analysis

The bill aims to maximize the expected value of Alaska's taxes. The bill would require that disputed tax amounts would be deposited in an Alaska bank escrow account invested in time deposits guaranteed by the United States. Further, if an assessment is for more than \$10 million and the disputed amount is for a tax year 5 years prior to the year of the assessment the taxpayer would be required to pay one-half of the assessment.

The attempt to acquire part of the outstanding assessment may or may not maximize the State's expected revenue share. Because the rate of interest payable for over and under payments exceeds the rate established by this bill for the escrow account, it is possible that the State would, if it did not prevail on a significant portion of the disputed amount, suffer a revenue loss.

Appendices

1. Outline of TAPS Settlement (c. January 10, 1985)
2. Briefing Materials for the Alaska State Legislature Regarding the TAPS Settlement Agreement (March 18, 1985)
3. The October 23 / November 14, 1985 Exemplary Tables

Appendices

1. Outline of TAPS Settlement (c. January 10, 1985)
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3. The October 23 / November 14, 1985 Exemplary Tables

Appendix 1. Outline of TAPS Settlement (c. January 10, 1985)

These principles approved before started negotiations.  
Expressed by legislature in 1962, by Governor, and  
reaffirmed in continued conversations with legislators  
during course of settlement  
If principles were different, then settlement not as  
attractive

#### COMPARED TO CONTINUED LITIGATION - CHARTS IV - VII AND GRAPHS

If don't settle, then will continue to litigate until about  
1990

For those years, would see the present tariff of \$6.01  
In 1990 (approximately), might see end of case, generally  
three possible outcomes

1) DOC - Depreciated original cost - state's position

\$3.113 Billion more to state (\$2.641 billion  
in 1985\$) than settlement

Mostly gets state more money in 1990 - 1993  
From 1994 - 2011, not a great deal of  
difference

2) TOC - Trended original cost - court's apparent  
favorite position

\$9.18 billion worse for state than settlement  
(\$2.5 billion in 1985\$)

Most of difference is in 1990 - 2011, about  
\$200 million annually in 1985\$

3) MODERN VALUATION - companies' position

\$11.8 billion worse for state than settlement  
(\$4.3 billion in 1985\$)

Like TOC, difference in years after 1990

Under TOC and Modern Valuation, not only is state worse off  
than settlement in overall dollars, but difference  
occurs in years state can least afford, after 1993, and  
when development is most sensitive to low tariffs

And, although DOC is better overall result, not much better  
in years state is most concerned about

Overall, is a bit better than midway between bad and good  
litigation outcomes in 1985\$

We get what we want from 1990 on, companies get most of what  
they want from 1977 - 1984, a "draw" from 1985 to 1990

Compared to Spring '82, this settlement is \$3.6 billion  
better (\$1.6 billion in 1985\$) - CHART VII

Between best and worst case, \$15 billion at stake (\$7  
billion in 1985\$)

Settlement gets state \$11.9 billion of that amount  
(\$4.5 billion of 1985\$ at stake)

#### TERMS OF SETTLEMENT

Through year 2011, although can get out by 2008  
Get operating costs, taxes, DR&R, etc. (out of pocket  
expenses)

Normal regulatory principles

"Profit" element is a hybrid method through 1988, then  
switches to a 35 cent (1983\$) per barrel profit,  
escalated for inflation

Replaces depreciation allowance, rate of return on  
rate base, etc.

Other feature

\$450 million reduction in rate base

Separate profit element for large capital additions

A common tariff ceiling (that will probably produce  
same tariffs for all)

#### SUMMARY

##### FACTORS IN FAVOR OF SETTLEMENT

- 1) REPRESENTS A MIDWAY COMPROMISE OF LITIGATION
- 2) MEETS POLICY GOALS OF DEFERRING REVENUE TO 1990'S AND  
ENCOURAGING NORTH SLOPE PRODUCTION
- 3) GIVES CERTAINTY WELL BEFORE LITIGATION WOULD
- 4) INSULATES THE STATE FROM MUCH WORSE POTENTIAL OUTCOMES
- 5) ENDS WHAT IS, TO OUR KNOWLEDGE, THE MOST COSTLY AND  
COMPLICATED LITIGATION IN U.S. HISTORY  
If didn't settle, case would probably go on for 5  
years or more before state saw any real money
- 6) STATE WOULD SEE AN IMMEDIATE INCREASE IN REVENUES FROM  
PRESENT TARIFFS  
\$233 million by January 1, 1986, comparable gains  
thereafter
- 7) STATE WOULD NOT HAVE PROBLEM OF COLLECTING ITS SHARE OF  
REFUNDS IN PAST SEVERANCE TAXES AND ROYALTIES  
If won litigation, would have to chase down past  
royalty-in-kind buyers  
for refunds, plus

# Alaska State Legislature

WILHELM LEWIS, Chairman  
Vice Chairmen  
...  
...  
...



POUCH V  
JUNEAU, ALASKA 99811  
(907) 465 4907

Dept. of Law  
1/10/85

## Senate Committee on Resources March 19, 1985

TO: All Members  
Senate Resources Committee  
Senate Finance Committee  
House Special Committee on Oil and Gas

FROM: Senate Resources Committee Staff *ME*

RE: TAPS Tariff Settlement

Enclosed in this packet is a series of documents that are helpful in understanding the proposed TAPS tariff settlement. I have listed the documents below and commented briefly upon each.

- 1) Immediately under this page is a March 14th memo that outlines the proposed schedule for the March 18th, 1:30 PM, overview hearing in the Rutrovich Room.
- 2) A historical overview of the TAPS tariff issue. This document was prepared by Gretchen Keiser, of the House Research Agency, at the request of the House Special Committee on Oil and Gas. A knowledge of the history of this issue is very useful in understanding the goals that the proposed settlement tries to achieve.
- 3) A short summary of the settlement prepared by the Department of Law in early January. The summary sets out the financial implications of the settlement and compares them against other possible scenarios.
- 4) The actual settlement contract that is currently proposed between the state and ARCO.
- 5) A February 22, 1985 memo from Commissioner Nordale of the Department of Revenue to Attorney General Norm Gorsuch listing some concerns about the proposed settlement.
- 6) A February 22, 1985 reply to Commissioner Nordale from the Attorney General by Rob Mavnard.
- 7) A report prepared by Connie Parlow of ARTA Inc., under a contract with the Senate Resources Committee to provide an analysis of the proposed settlement.

If time is not available to read all the documents, I would recommend as a priority; the Department of Law's Summary (3), and the summary of Ms. Parlow's work (?). I would then proceed to Ms. Keiser's history (2) and the remainder of Ms. Parlow's report (7). There are blue sheets between each section.

## OUTLINE OF TAPS SETTLEMENT

### HAVE REACHED AN AGREEMENT WITH ARCO

Final document in next 3-4 weeks  
Not all companies on board  
Numbers are if all join up

### TAPS TARIFF DIRECTLY AFFECTS ANS WELLHEAD PRICE

Severance tax and royalty on wellhead  
No market at wellhead  
Decrease in tariff directly increases wellhead  
We get 25-30% of wellhead increase from state lands

### REVENUE CONSEQUENCES TO STATE - CHART I AND GRAPH

\$2.9 billion more than currently forecast (\$2.14 billion in 1985\$)  
Annual accounts gained (millions)

|      | <u>Calendar</u> | <u>Fiscal</u> |
|------|-----------------|---------------|
| 1985 | \$233.0         |               |
| 1986 | \$153.6         | \$309.8       |
| 1987 | \$200.4         | \$177.0       |
| 1988 | \$232.3         | \$216.4       |
| 1989 | \$256.2         | \$244.3       |
| 1990 | \$261.7         | \$259.0       |
| 1991 | \$235.7         | \$248.7       |

Effective date of settlement would be January 1, 1986  
Tariffs would drop in 1985 by 72 cents, and continue to drop in later years, both in real and nominal terms CHARTS II AND III AND GRAPHS

### PRINCIPLES OF SETTLEMENT

- 1) State wants to defer revenues to 1990's  
A constant dollar in the 1990's is worth the same to the state as that same dollar today
- 2) Encourage development of ANS reserves in 1990's  
Prudhoe and Kuparuk already on stream with present tariffs  
Low 1990s tariffs will encourage places like Beaufort, native lands and other fields where production might not otherwise be economic  
Certainty now aids economic planning for 90's - litigation makes planning uncertain

Appendix 2. Briefing Materials for the Alaska State Legislature Regarding the TAPS  
Settlement Agreement (March 18, 1985)

retroactively assess the producers for increased severance tax and royalties. Resistance on all fronts is likely

- 8) IS MOST FAVORABLE SETTLEMENT WE CAN GET - MORE FAVORABLE RESULTS CAN BE REACHED ONLY BY LITIGATION  
This settlement has taken 1-1/2 years, is limit companies can offer  
In fact, unlikely all companies will join  
Only reason we could get this good a deal was that we are interested in deferring revenues, while companies want money up front. But if we change our policy and want more money up front, then clash with their interests more directly
- 9) IF LITIGATE, AND EVEN IF WIN, WON'T SEE ANY REVENUES FOR AT LEAST 5 YEARS, BUT HAVE IMMEDIATE GAINS UNDER SETTLEMENT

#### RISKS OF SETTLEMENT

- 1) GIVING UP THE CHANCE OF A BIG VICTORY - \$2.6 BILLION MORE (1985\$)  
Although chance of losing more, have chance of winning
- 2) IF UNDERLYING POLICY HAS CHANGED (DEFERRING REVENUES AND ENCOURAGING POST 1990 ANS PRODUCTION), THEN SETTLEMENT IS LESS ATTRACTIVE
- 3) SETTLEMENT IS ALSO A DIFFICULT PATH  
Right now only have Arco, no guarantee that other companies will join  
May have to get F.E.R.C. to impose on parties, or go to Congress  
May take some months to secure  
Long process involved

TABLE OF CONTENTS

1. Letter from Alaska State Legislature to Attorney General Condon
2. Letter to U.S. Department of Justice to Attorney General Gorsuch and Francis X. McCormack
3. Key Events in the TAPS Case
4. Key Events in the Williams Case
5. Federal Energy Regulatory Commission
6. TSM Tariff
7. TSM Tariff v. Spring '82 Tariff
8. TSM Tariff v. DOC Tariff
9. TSM Tariff v. TOC and Modern Valuation Tariffs
10. TSM Tariffs Under Alternative Throughput Scenarios
11. TSM Tariff v. Conventional TSM Tariff
12. Composition of TSM Tariffs (constant 1984 dollars)
13. Composition of TSM Tariffs (nominal dollars)
14. Beaufort Sea Oil Production Under Alternative Tariffs, 1993-2018
15. Beaufort Sea Oil Production Under Alternative Tariffs, 1993-2018

SUMMARY OF EXHIBITS

1. Letter from Alaska State Legislature to Attorney General Condon
  - Letter from Chairmen of House Special Gas Pipeline Committee and Senate Resources Committee stating that the State should not proceed with the proposed settlement with BP Pipelines.
2. Letter to U.S. Department of Justice to Attorney General Gorsuch and Francis X. McCormack
  - Letter from Assistant Attorney General for Antitrust approving TAPS settlement.
3. Key Events in the TAPS Case
  - Chronological summary of key events in the TAPS case.
4. Key Events in the Williams Case
  - Chronological summary of key events in the Williams case.
5. Federal Energy Regulatory Commission
  - Shows the relationship among the Federal Energy Regulatory Commission (FERC), the Administrative Law Judge (ALJ), and the FERC Staff Counsel.
  - Phases I and II of the TAPS case were tried before an ALJ. Phase I was appealed to FERC in 1980 and is still pending.
  - FERC Staff Counsel was a participant in both the Phase I and Phase II hearings. In its role as a participant in the proceedings, Staff Counsel reports only to the Assistant General Counsel. Neither the Assistant General Counsel nor the Staff Counsel is permitted to communicate with, or receive directions from, the Commission concerning a pending proceeding such as the TAPS case.
6. TSM Tariff<sup>\*</sup>
  - Tariff profile of TAPS Settlement Methodology (TSM).
  - Based upon State's median throughput scenario.

Sen. Res.  
3/18/05

BRIEFING MATERIALS FOR  
THE ALASKA STATE LEGISLATURE  
REGARDING  
THE TAPS SETTLEMENT AGREEMENT

1

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Official Business

# Alaska State Legislature

Pouch V  
State Capitol  
Juneau, Alaska 99811

May 17, 1982

RECEIVED  
Department of Law  
Juneau, Alaska

AM MAY 18 1982 PM  
7:49:00Z 12:18:00Z

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

Dear Will:

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 revenue 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/BP/ls

7. TSM Tariff v. Spring '82 Tariff<sup>\*/</sup>
- Compares tariff profile produced by TSM to tariff profile produced by proposed State - BP settlement in Spring 1982.
  - Spring '82 tariff profile projected beyond the term of the settlement (10 years) for comparison purposes.
8. TSM Tariff v. DOC Tariff<sup>\*/</sup>
- Compares tariff profile produced by TSM to tariff profile produced by Depreciated Original Cost (DOC) methodology.
  - DOC generally represents the most favorable methodological outcome for the State.
9. TSM Tariff v. TOC and Modern Valuation Tariffs<sup>\*/</sup>
- Compares tariff profile produced by TSM to tariff profiles produced by Trended Original Cost (TOC) methodology and Modern Valuation methodology.
  - TOC and Modern Valuation represent the least favorable methodological outcomes for the State.
10. TSM Tariffs Under Alternative Throughput Scenarios<sup>\*/</sup>
- Compares tariff profiles produced by TSM under alternative State Department of Natural Resources throughput scenarios.
11. TSM Tariff v. Conventional TSM Tariff<sup>\*/</sup>
- Compares tariff profile produced by TSM with tariff profile that would be produced by the TSM with the following changes:
    - (1) No \$.055 per barrel allowance after 1988 (i.e., continuation of 6.4% return on rate base after 1988);
    - (2) Conventional straight line depreciation factors (which is consistent with the State's litigation position); and
    - (3) Conventional straight line dismantling, removal and restoration provision (which is consistent with the State's litigation position).
12. Composition of TSM Tariffs (constant 1984 dollars)
- Breaks the tariffs produced by TSM into four basic components and shows how the relative magnitudes of those components change over time.
  - Operating Expenses are net of de minimis non-transportation revenues.
  - Depreciation also includes recovery of deferred return; an amount for the dismantling, removal and restoration of TAPS; and the amortization of the \$450 million excluded from the rate base.
13. Composition of TSM Tariffs (nominal dollars)
- Breaks the tariffs produced by TSM into four basic components and shows how the relative magnitudes of those components change over time.
  - Operating Expenses are net of de minimis non-transportation revenues.
  - Depreciation also includes recovery of deferred return; an amount for the dismantling, removal and restoration of TAPS; and the amortization of the \$450 million excluded from the rate base.
14. Beaufort Sea Oil Production Under Alternative Tariffs, 1993-2018
- Compares Beaufort Sea oil production under DOC, TSM and Modern Valuation tariffs.
  - Uses State Department of Natural Resources oil price forecast for 1993, escalated thereafter at the real rate of 1% per year.
15. Beaufort Sea Oil Production Under Alternative Tariffs, 1993-2018
- Compares Beaufort Sea oil production under DOC, TSM, Spring '82, TOC and Modern Valuation tariffs.
  - Uses State Department of Natural Resources oil price forecast for 1993, escalated thereafter at the real rate of 1% per year.

<sup>\*/</sup> Tariff projections are based on assumptions concerning rate of return on rate base, throughput, operating expenses and other amounts. Tariffs are expressed in constant 1984 dollars.



U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

December 27, 1984

Honorable Norman C. Gorsuch, Esquire  
Attorney General  
State of Alaska  
Department of Law  
Pouch K, State Capitol  
Juneau, Alaska 99811

Francis X. McCormack, Esquire  
Senior Vice President and  
General Counsel  
Atlantic Richfield Company  
Room 5001  
515 South Flower Street  
Los Angeles, California 90071

Re: Trans Alaska Pipeline System,  
FERC Docket No. OR78-1

Dear Attorney General Gorsuch and Mr. McCormack:

I am writing in response to Robert H. Loeffler's letter to me of December 7, 1984, in which the State of Alaska and ARCO Pipe Line Company request that the Department of Justice approve an agreement in principle to a proposed life-of-the-pipeline settlement of all aspects of the Trans Alaska Pipeline System (TAPS) litigation pending before the Federal Energy Regulatory Commission (FERC).


We have been giving careful consideration to the statement you provided of the essential features of the proposed settlement and the supporting technical memoranda and computer programs that embody its details. In addition, the Antitrust Division staff has engaged in a number of discussions with Alaska's and ARCO's representatives regarding the methodology and economic consequences of the proposed settlement and the manner in which it would be presented to the Federal Energy Regulatory Commission. It is our understanding that you are currently in the process of drafting a formal settlement agreement and the appropriate supporting documents that must be

prepared before the settlement proposal can be submitted to the FERC and that these documents are scheduled to be completed by the end of January 1985.

Based upon the material the Department has reviewed and the extensive discussions between the Department's representatives and those of Alaska and ARCO, the Department agrees in principle that the proposed settlement is an acceptable resolution of the TAPS litigation. The Department's formal agreement, of course, is subject to its review and approval of the final settlement documents. It is subject also to adoption of the proposed settlement by the FERC as the basis upon which the rates of all of the undivided interest owners of TAPS will be set. Subject to the conditions set forth above, we support your continuing efforts to broaden the proposed settlement to include other parties in the proceeding, to complete the process of documenting the settlement, and to obtain its approval from the FERC.

Of course, the Department's views regarding the settlement proposal are confined solely to the TAPS litigation and do not represent or affect in any way the position of the Department regarding pipeline regulation in general, Williams Pipe Line Company, FERC Docket No. OR79-1 in particular, or any other proceeding pending before the FERC. Nonetheless, given the overall economic impact of the proposed settlement on the transportation, production and marketing of Alaska North Slope crude oil, the Department believes that the proposed settlement should be a fair and appropriate vehicle for concluding the TAPS litigation and for freeing the public and private resources that its continuance would otherwise consume.

Sincerely,

  
J. Paul McGrath  
Assistant Attorney General  
Antitrust Division

cc: Robert H. Loeffler, Esquire  
Morrison & Foerster  
1920 N. Street, N. W.  
Suite 800  
Washington, D. C. 20036

Robert E. Jordan, Esquire  
Steptoe & Johnson  
Chartered  
1250 Connecticut Avenue, N. W.  
7th Floor  
Washington, D. C. 20036



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Washington, D. C. 20036

(M)

KEY EVENTS IN THE TAPS CASE

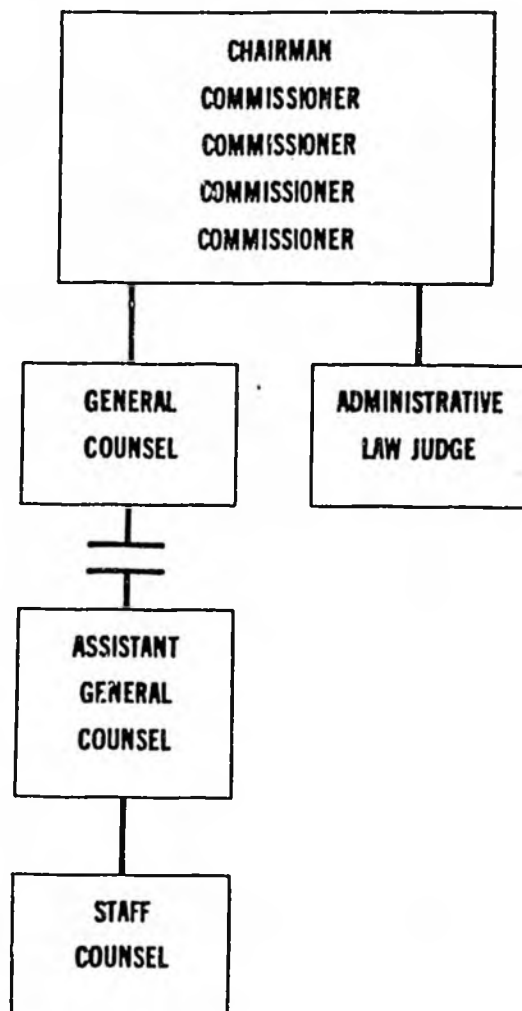
| <u>Date</u>                   | <u>Event</u>                                                                                                                                                                                                                      |
|-------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| June 1977                     | TAPS Carriers file tariffs with Interstate Commerce Commission (ICC). State of Alaska, Department of Justice, Arctic Slope Regional Corporation (ASRC) file protests.                                                             |
| October 1977                  | ICC's jurisdiction over oil pipelines transferred to the newly-created Federal Energy Regulatory Commission (FERC). TAPS case is divided into Phase I (general ratemaking methodology) and Phase II (specific ratemaking issues). |
| February 1978 - March 1979    | Administrative Law Judge (ALJ) holds hearings in Phase I.                                                                                                                                                                         |
| March 1979                    | ALJ proposes settlement of Phase I.                                                                                                                                                                                               |
| February 1980                 | ALJ issues 138-page opinion in Phase I that finds TAPS Carriers' rates are too high.                                                                                                                                              |
| July 1980                     | Appeal of Phase I is argued before the FERC.                                                                                                                                                                                      |
| November 1980 - January 1982  | State engages in settlement talks with ARCO, BP, Exxon, and Sohio. BP takes primary role in negotiations.                                                                                                                         |
| February 1981                 | State, Justice, and ASRC file a motion with FERC requesting FERC to decide Phase I. FERC denies the motion.                                                                                                                       |
| July 1981                     | State rejects offers of settlement.                                                                                                                                                                                               |
| February 1982 - December 1984 | ALJ holds hearings in Phase II.                                                                                                                                                                                                   |
| March 1982                    | State receives settlement offer from BP.                                                                                                                                                                                          |
| April 1982                    | Governor Hammond recommends to the legislature that the State accept the BP offer. Justice proposes alternative settlement framework.                                                                                             |

| <u>Date</u>                  | <u>Event</u>                                                                                                                                                                                                                                     |
|------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| May 1982                     | Legislature informs Governor Hammond that it believes the State should continue the Phase I litigation because of concerns over developmental effects and the length of the settlement.                                                          |
| July 1982                    | State and Justice file motion with FERC requesting expedited decision in Phase I.                                                                                                                                                                |
| July 1982                    | FERC denies motion for expedited decision saying order in <u>Williams</u> will be accompanied by order in TAPS.                                                                                                                                  |
| November 1982                | FERC remands Phase I to ALJ for hearings on whether TAPS should be governed by its <u>Williams</u> decision.                                                                                                                                     |
| April 1983 - February 1984   | State engages in settlement talks with ARCO, BP and Exxon and also has contacts with Sohio.                                                                                                                                                      |
| January 1984 - February 1984 | ALJ holds Phase I Remand hearings.                                                                                                                                                                                                               |
| March 1984                   | Court of Appeals for the D.C. Circuit remands <u>Williams</u> to FERC. State, Justice, and ASRC file motion with FERC requesting FERC to decide Phase I since the Court of Appeals decision makes the Phase I Remand moot. FERC takes no action. |
| September 1984               | State engages in settlement talks with ARCO and BP and also has contacts with Sohio and Exxon.                                                                                                                                                   |
| November 1984                | State reaches handshake agreement with ARCO that settles both Phase I and Phase II.                                                                                                                                                              |
| December 1984                | Justice approves State-ARCO agreement.                                                                                                                                                                                                           |
| February 1985                | State and ARCO sign agreement settling both Phase I and Phase II.                                                                                                                                                                                |

KEY EVENTS IN THE TAPS CASE

| <u>Date</u>                      | <u>Event</u>                                                                                                                                                                                                                      | <u>Date</u>                     | <u>Event</u>                                                                                                                                                                                                                                     |
|----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| June 1977                        | TAPS Carriers file tariffs with Interstate Commerce Commission (ICC), State of Alaska, Department of Justice, Arctic Slope Regional Corporation (ASRC) file protests.                                                             | May 1982                        | Legislature informs Governor Hammond that it believes the State should continue the Phase I litigation because of concerns over developmental effects and the length of the settlement.                                                          |
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| March 1979                       | ALJ proposes settlement of Phase I.                                                                                                                                                                                               | April 1983 -<br>February 1984   | FERC remands Phase I to ALJ for hearings on whether TAPS should be governed by its <u>Williams</u> decision.                                                                                                                                     |
| February 1980                    | ALJ issues 138-page opinion in Phase I that finds TAPS Carriers' rates are too high.                                                                                                                                              | January 1984 -<br>February 1984 | State engages in settlement talks with ARCO, BP and Exxon and also has contacts with Sohio.                                                                                                                                                      |
| July 1980                        | Appeal of Phase I is argued before the FERC.                                                                                                                                                                                      | March 1984                      | ALJ holds Phase I Remand hearings.                                                                                                                                                                                                               |
| November 1980 -<br>January 1982  | State engages in settlement talks with ARCO, BP, Exxon, and Sohio. BP takes primary role in negotiations.                                                                                                                         |                                 | Court of Appeals for the D.C. Circuit remands <u>Williams</u> to FERC. State, Justice, and ASRC file motion with FERC requesting FERC to decide Phase I since the Court of Appeals decision makes the Phase I Remand moot. FERC takes no action. |
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| July 1981                        | State rejects offers of settlement.                                                                                                                                                                                               | November 1984                   | State reaches handshake agreement with ARCO that settles both Phase I and Phase II.                                                                                                                                                              |
| February 1982 -<br>December 1984 | ALJ holds hearings in Phase II.                                                                                                                                                                                                   | December 1984                   | Justice approves State-ARCO agreement.                                                                                                                                                                                                           |
| March 1982                       | State receives settlement offer from BP.                                                                                                                                                                                          | February 1985                   | State and ARCO sign agreement settling both Phase I and Phase II.                                                                                                                                                                                |
| April 1982                       | Governor Hammond recommends to the legislature that the State accept the BP offer. Justice proposes alternative settlement framework.                                                                                             |                                 |                                                                                                                                                                                                                                                  |

**FEDERAL ENERGY REGULATORY COMMISSION  
(FERC)**



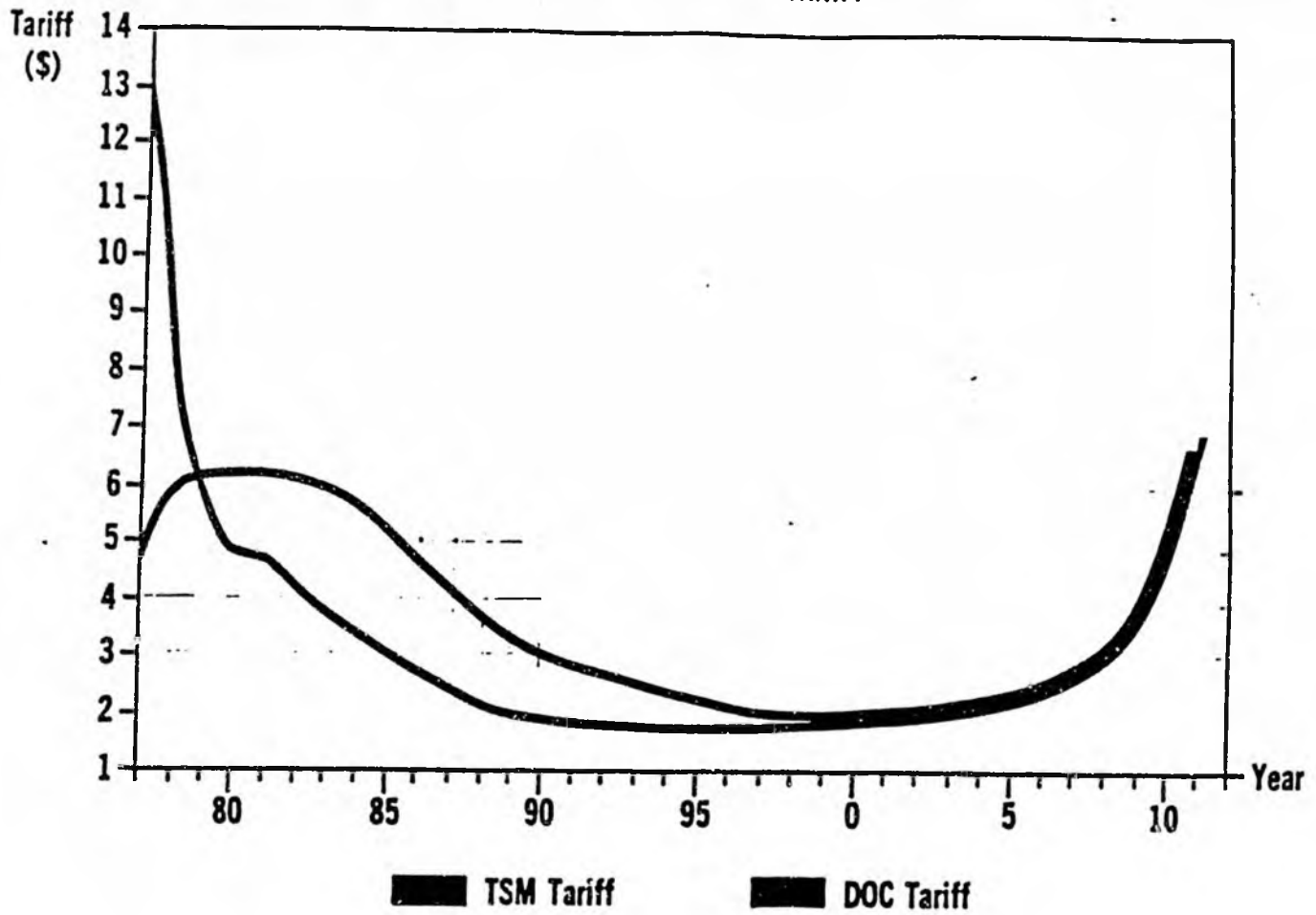
(4)

KEY EVENTS IN THE WILLIAMS CASE

| <u>Date</u>                  | <u>Event</u>                                                                                                                                                            | <u>Date</u>   | <u>Event</u>                                                                                                                                                                                                                                                                                                |
|------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| December 1971                | Shippers file protests against Williams rates with Interstate Commerce Commission (ICC).                                                                                | March 1984    | Court of Appeals for the D.C. Circuit remands FERC's Phase I decision; states that FERC should issue a new decision within 12 months.                                                                                                                                                                       |
| June 1974                    | Administrative Law Judge (ALJ) issues opinion upholding Williams rates.                                                                                                 | January 1985  | Parties submit settlement of Phase II to FERC.                                                                                                                                                                                                                                                              |
| November 1975                | ICC issues decision affirming ALJ's decision.                                                                                                                           | February 1985 | Court of Appeals for the D.C. Circuit orders FERC to report to it by March 8, 1985 (i.e., exactly 12 months after it remanded FERC's Phase I decision) on any steps FERC has taken regarding the Phase II settlement. The Court stated that it would not interfere with the schedule it had set in Phase I. |
| October 1977                 | ICC's jurisdiction over oil pipelines transferred to newly-created Federal Energy Regulatory Commission (FERC).                                                         | March 1985    | FERC approves Phase II settlement; states that it will issue Phase I decision "in the near future."                                                                                                                                                                                                         |
| June 1978                    | Court of Appeals for the D.C. Circuit remands ICC's <u>Williams</u> decision to FERC, and orders it to develop a viable precedent for oil pipeline ratemaking.          |               |                                                                                                                                                                                                                                                                                                             |
| February 1979                | FERC consolidates all <u>Williams</u> proceedings; divides the case into Phase I (general ratemaking methodology) and Phase II (specific ratemaking issues).            |               |                                                                                                                                                                                                                                                                                                             |
| July 1979 -<br>December 1979 | ALJ holds Phase I hearings.                                                                                                                                             |               |                                                                                                                                                                                                                                                                                                             |
| January 1980                 | FERC orders ALJ to omit a decision in Phase I, stating that "timely execution of our functions" requires FERC to decide the case in the first instance.                 |               |                                                                                                                                                                                                                                                                                                             |
| June 1981                    | Shippers ask the Court of Appeals for the D.C. Circuit to order FERC to decide Phase I. FERC pledges to decide Phase I by fall, 1981. Shippers' court action dismissed. |               |                                                                                                                                                                                                                                                                                                             |
| August 1982                  | Seeing no FERC action, shippers sue FERC in D.C. District Court; Court orders FERC to decide Phase I within 60 days.                                                    |               |                                                                                                                                                                                                                                                                                                             |
| November 1982                | FERC issues Phase I decision (Opinion No. 154).                                                                                                                         |               |                                                                                                                                                                                                                                                                                                             |

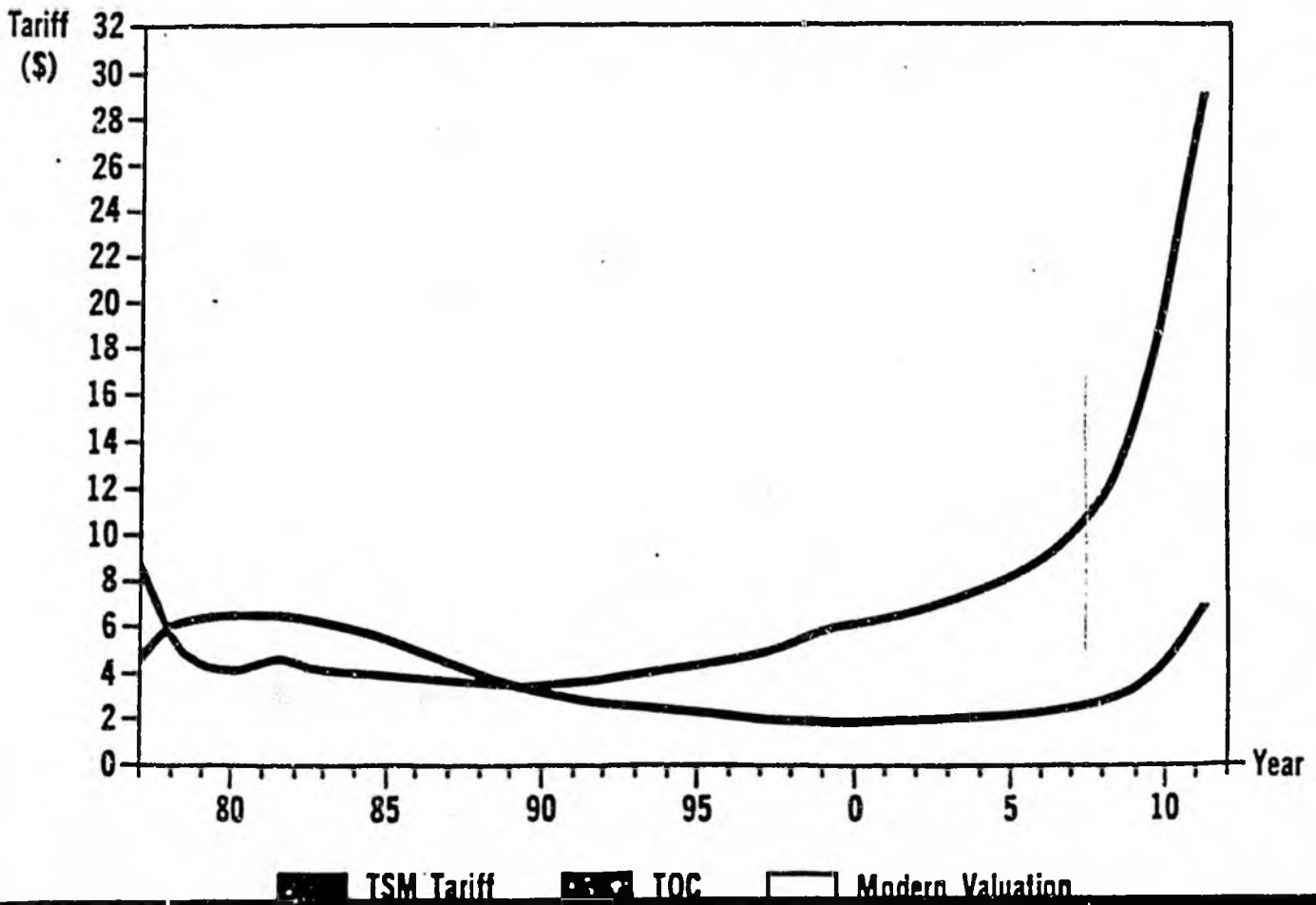
TSM TARIFF V. DOC TARIFF

8



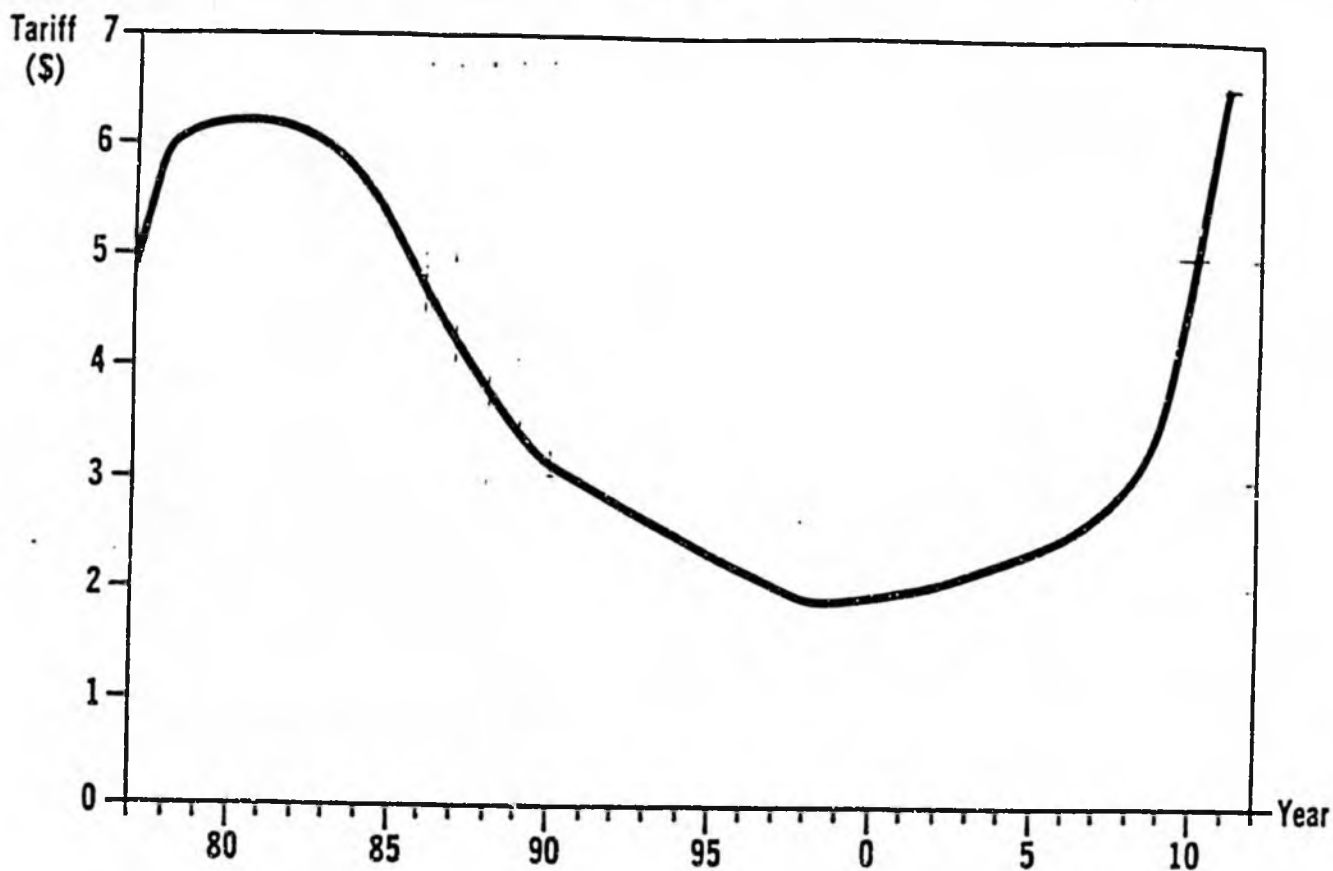
TSM TARIFF V. TOC AND MODERN VALUATION TARIFFS

9



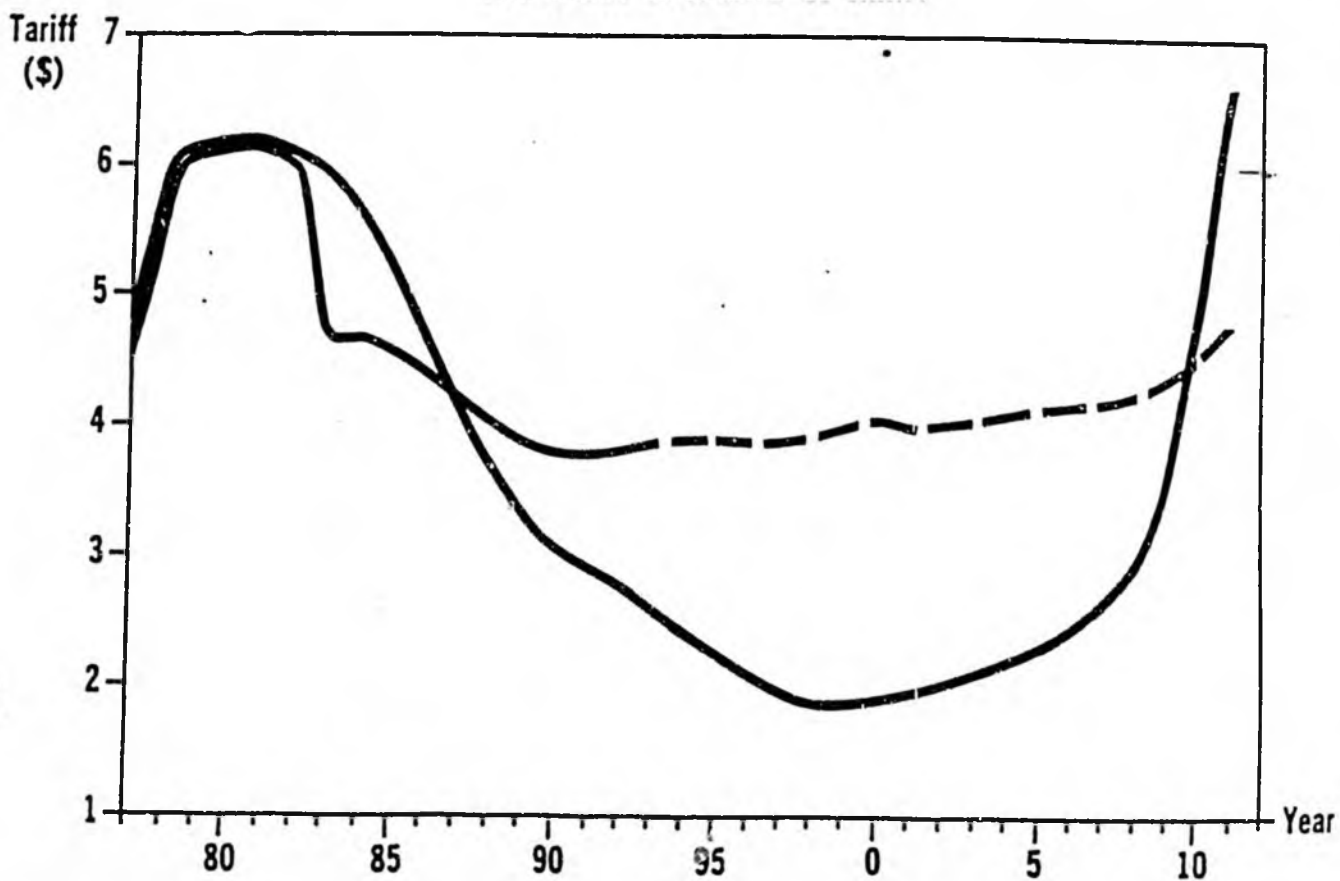
### TSM TARIFF

6



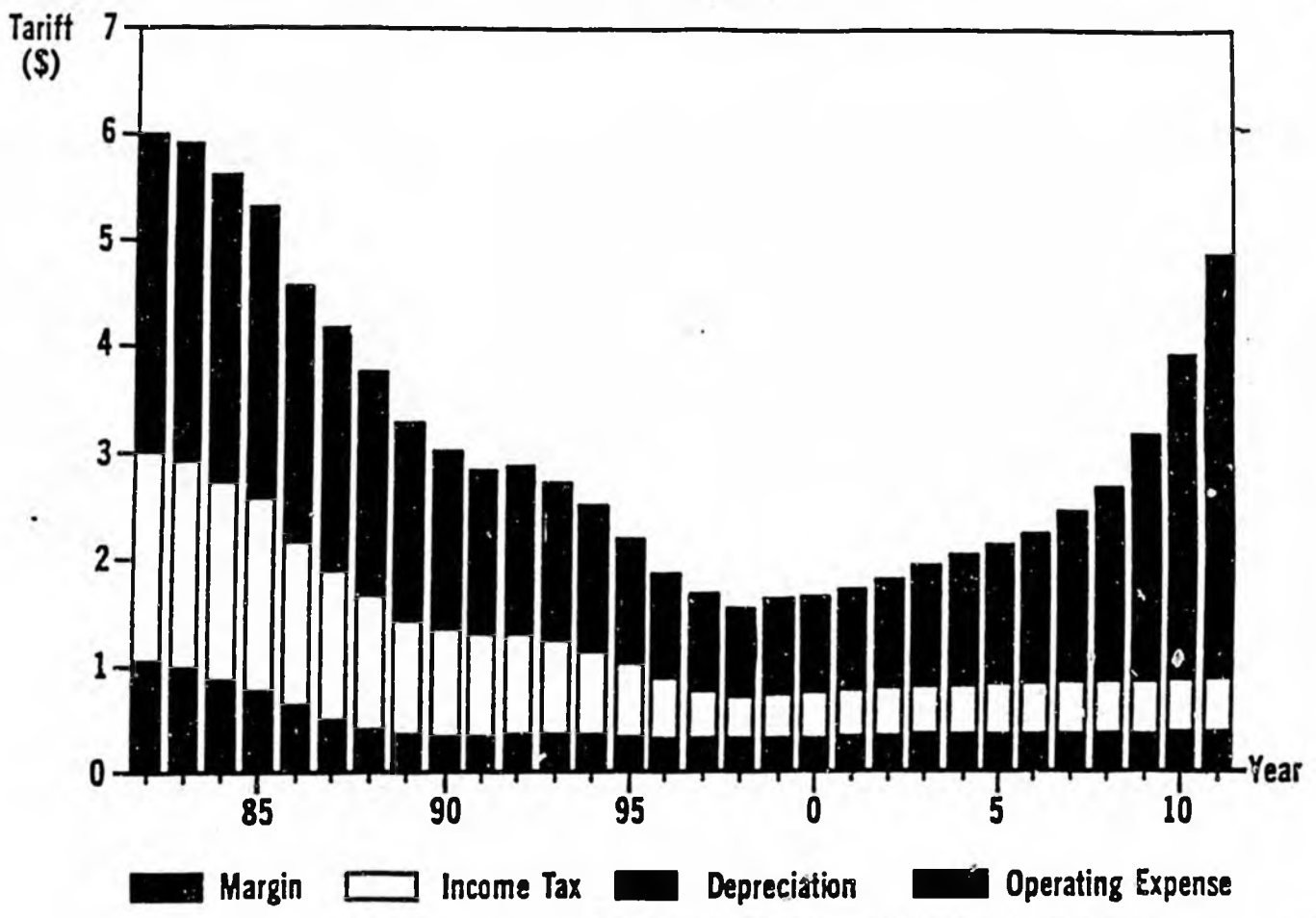
### TSM TARIFF V. SPRING '82 TARIFF

7



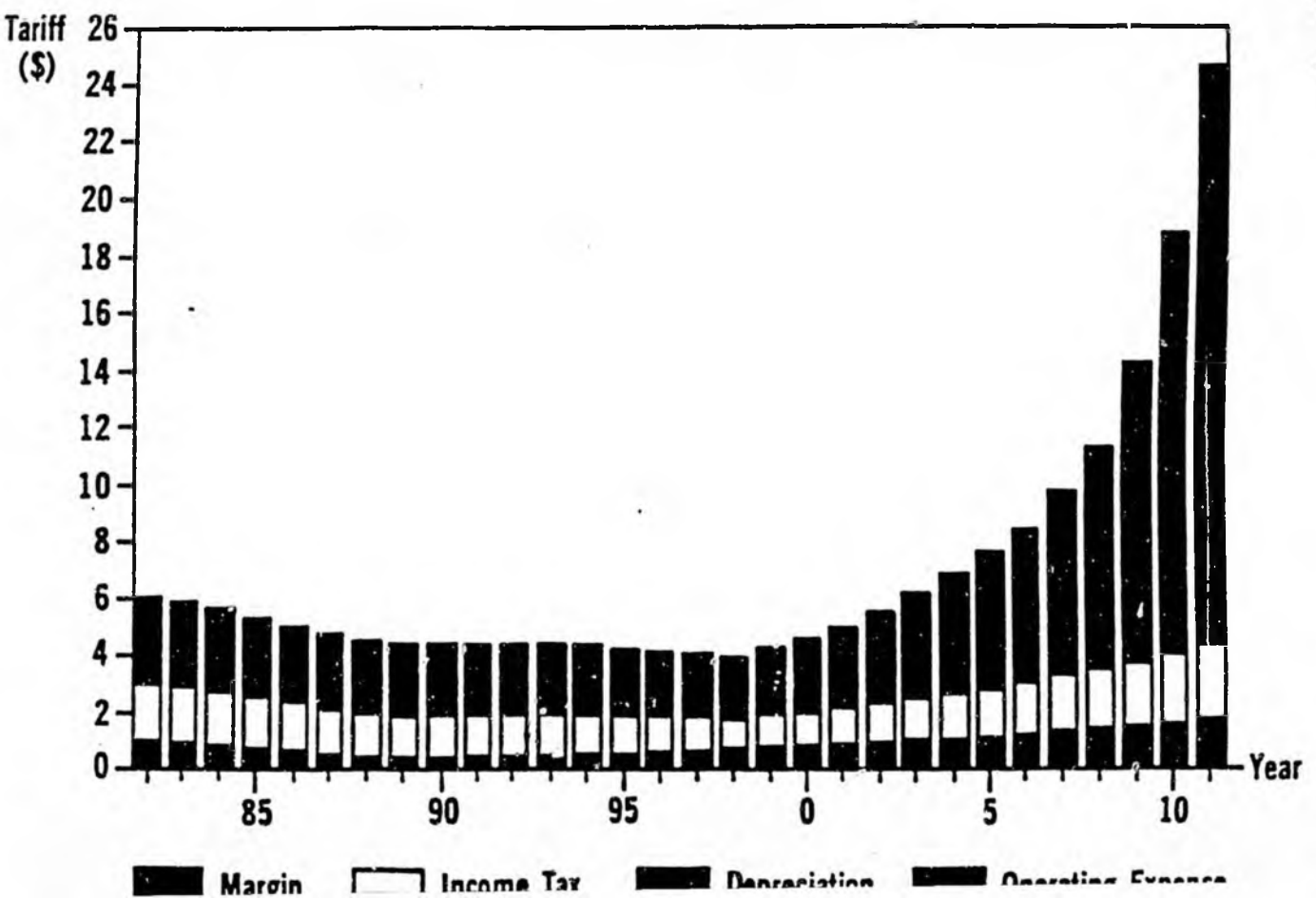
COMPOSITION OF TSM TARIFFS  
(constant 1984 dollars)

(12)



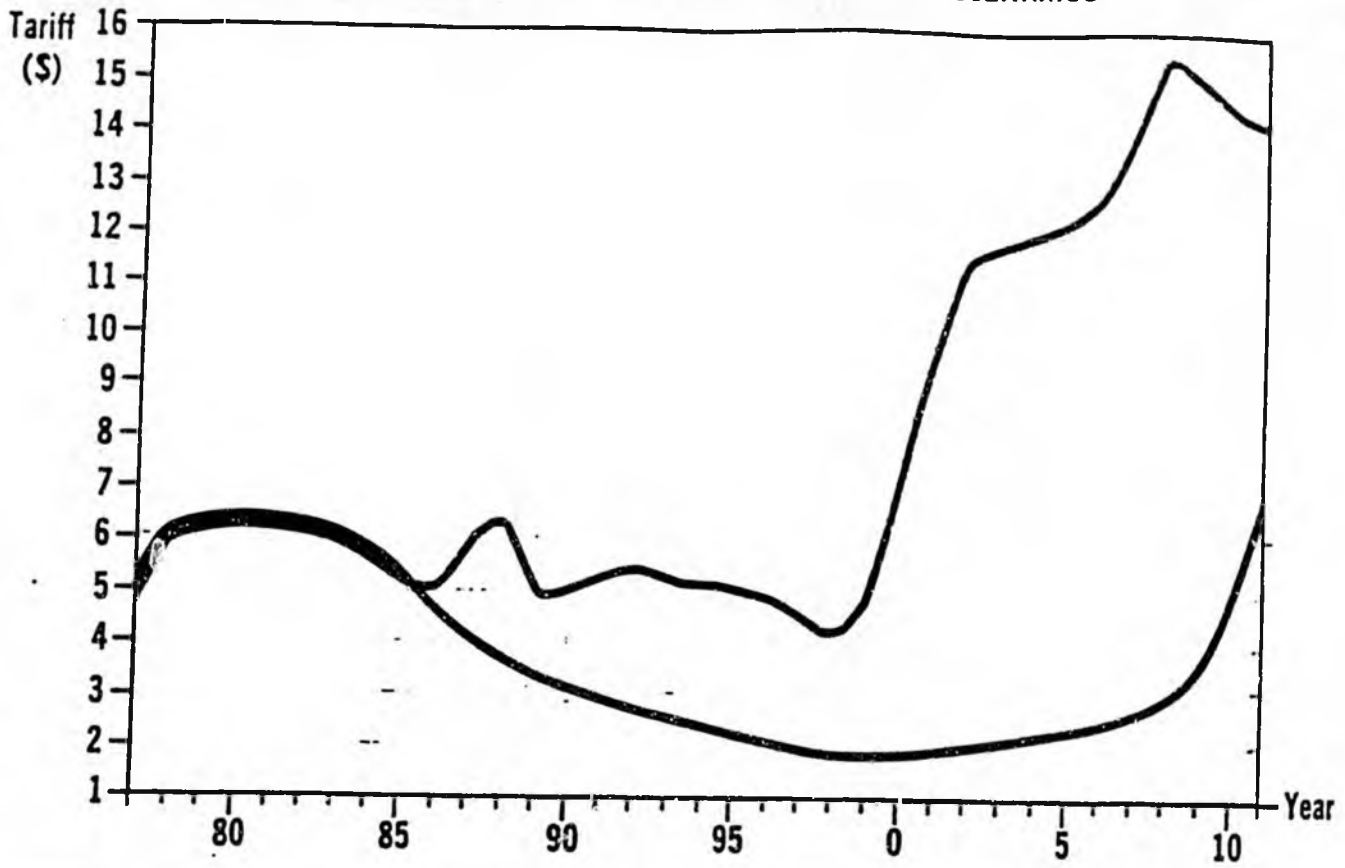
COMPOSITION OF TSM TARIFFS  
(nominal dollars)

(13)



### TSM TARIFFS UNDER ALTERNATE THROUGHPUT SCENARIOS

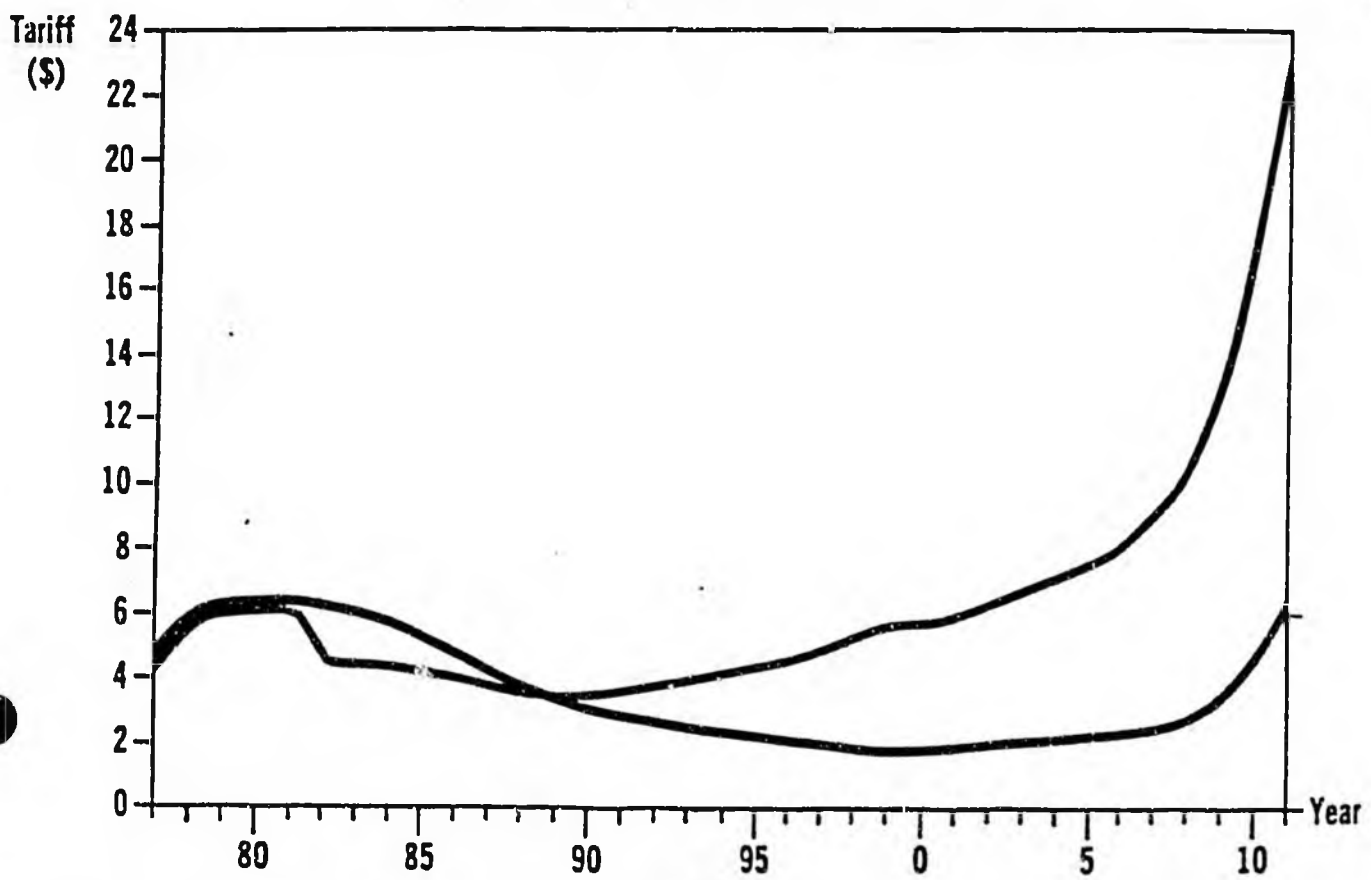
(10)



Low Throughput Scenario
  Median Throughput Scenario
  High Throughput Scenario

### TSM TARIFF V. CONVENTIONAL TSM TARIFF

(11)

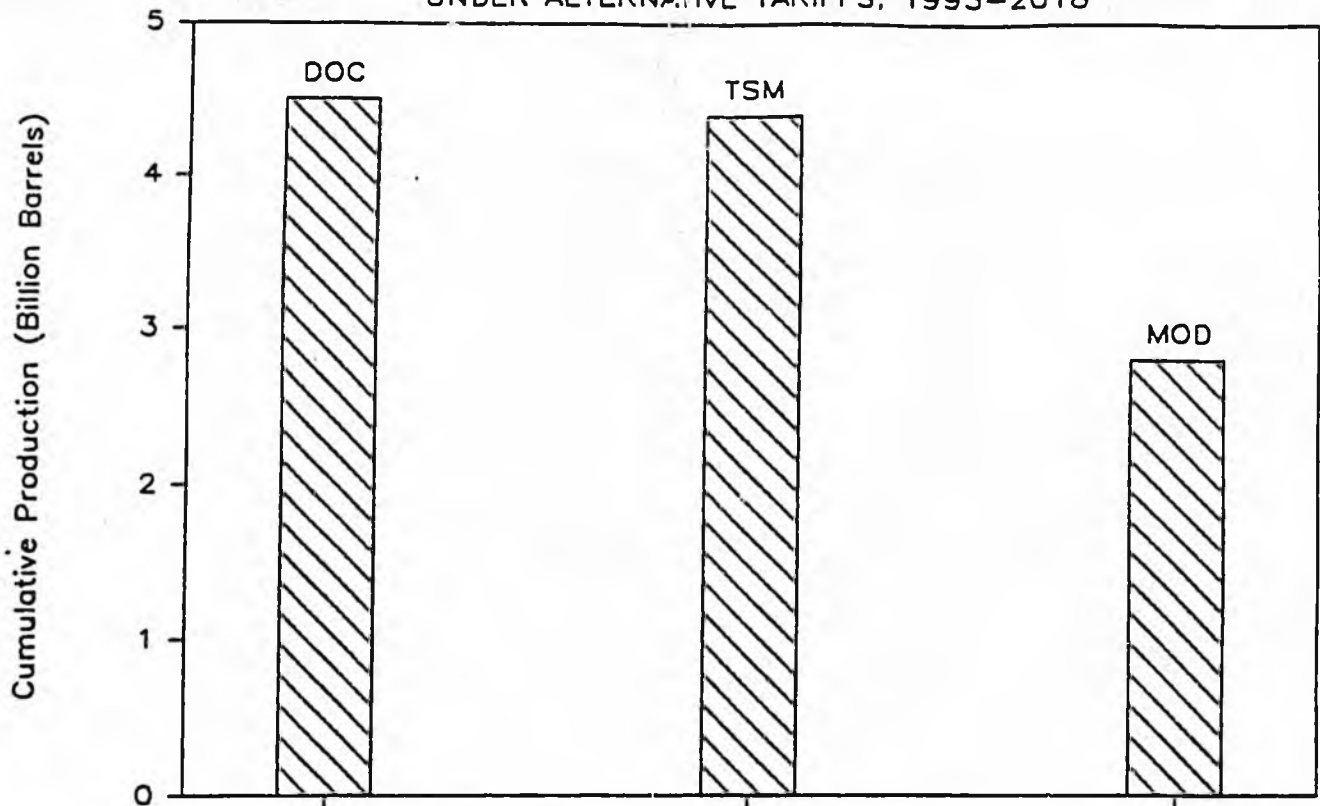


TSM Tariff
  Conventional TSM Tariff

Appendix 3. The October 23 and November 14, 1985 Exemplary Tables  
(from "TAPS" memoranda of October 23 and Nov. 14, 1985)

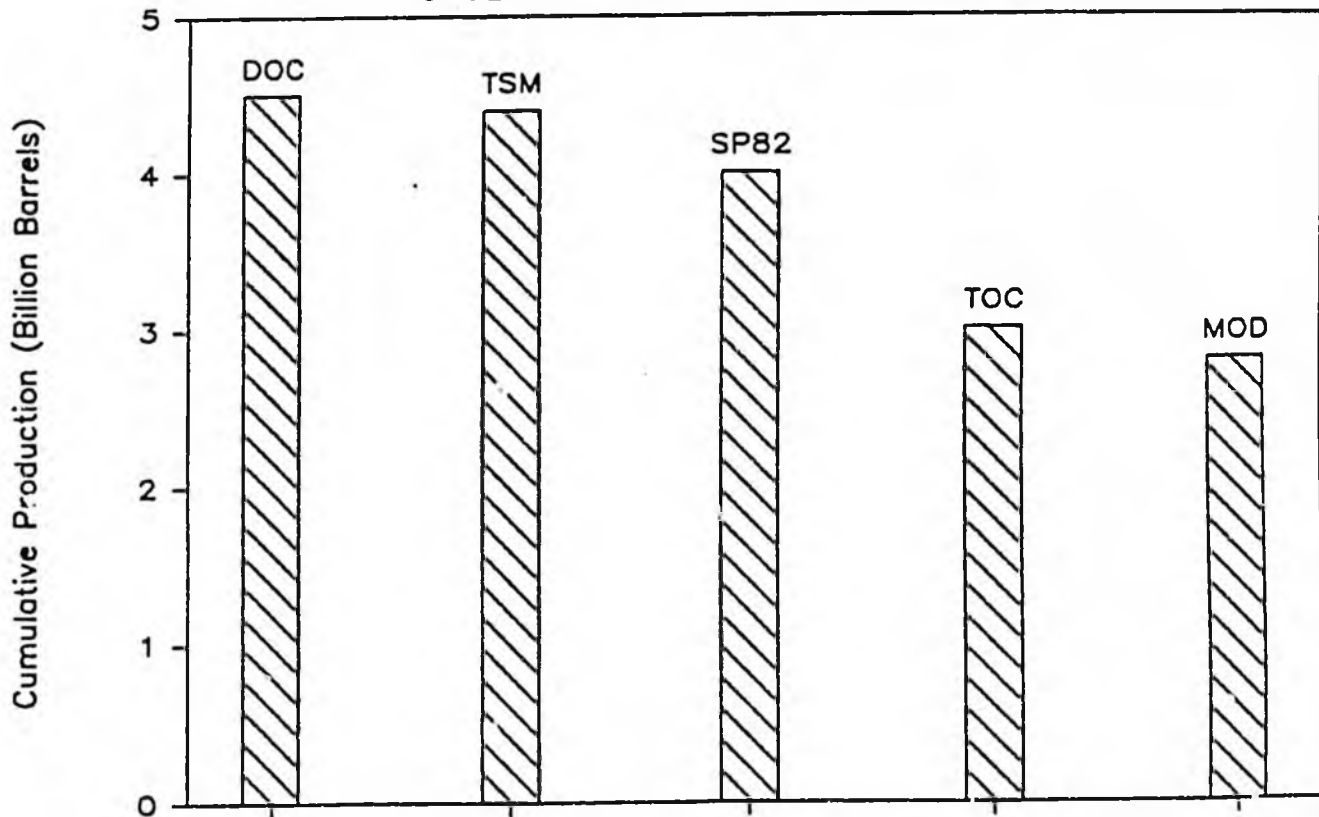
# BEAUFORT SEA OIL PRODUCTION

UNDER ALTERNATIVE TARIFFS, 1993-2018



# BEAUFORT SEA OIL PRODUCTION

UNDER ALTERNATIVE TARIFFS, 1993-2018



Note that at a real discount rate of 0 the total revenues remain unchanged (column 6 compared with 15 and 9 compared with 18). However, once a real discount rate is applied the value of monies received farther in the future begins to fall. Thus if the decisionmaker believes a quick decision will be forthcoming the litigation alternative is relatively more attractive than if the decisionmaker expects a litigated outcome to take a long time.

### 2.3 Debt/Equity Ratio

The debt/equity ratio makes a difference because the treatment of debt and equity differ in rate making methodologies. In Williams II FERC ruled "...that a pipeline which has issued no long-term debt or which issues long term debt to its parent or which issues long term debt guaranteed by its parent to outside investors should use its parent's actual capital structure"<sup>3/</sup> (emphasis added). This seems to imply that FERC has ruled on the appropriate debt/equity ratio for use by oil pipelines. However, clearly this can be changed on appeal and equally clearly the State may still argue for a more favorable (to the State) outcome. Since TAPS was built with 90% debt financing there is potentially a lot at stake in this argument.

10 years or 20 years. Table 2 gives an example of the potential impact on state revenues of a delay of 3 years versus a delay of 12 years in reaching a litigated decision (note that all other variables are held constant to develop this table).

Table 2

3 Year Delay

\$ 1985 (000,000)

Oct. 23

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DOC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1143             | 1352         | 2925                                | -937             | 1988         | 3474                           | 835              | 4309         |
| 2.0%          | 209                            | 1069             | 1278         | 2702                                | -590             | 2112         | 3210                           | 927              | 4137         |
| 4.0%          | 209                            | 991              | 1200         | 2500                                | -335             | 2135         | 2970                           | 930              | 3900         |
| 6.0%          | 209                            | 916              | 1125         | 2317                                | -218             | 2099         | 2752                           | 689              | 3641         |
| 8.0%          | 209                            | 846              | 1055         | 2150                                | -121             | 2029         | 2554                           | 626              | 3380         |
| 10.0%         | 209                            | 782              | 991          | 1998                                | -57              | 1941         | 2373                           | 756              | 3129         |
| 12.0%         | 209                            | 724              | 933          | 1859                                | -15              | 1844         | 2208                           | 665              | 2893         |

12 Year Delay

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1143              | 1352          | 3018                                | -1031             | 1988          | 5217                           | -907              | 4310          |
| 2.0%          | 209                            | 1069              | 1278          | 2333                                | -693              | 1640          | 4033                           | -570              | 3463          |
| 4.0%          | 209                            | 991               | 1200          | 1813                                | -473              | 1340          | 3133                           | -361              | 2772          |
| 6.0%          | 209                            | 916               | 1125          | 1415                                | -326              | 1069          | 2446                           | -231              | 2215          |
| 8.0%          | 209                            | 846               | 1055          | 1110                                | -226              | 882           | 1918                           | -150              | 1768          |
| 10.0%         | 209                            | 782               | 992           | 874                                 | -161              | 713           | 1511                           | -97               | 1414          |
| 12.0%         | 209                            | 724               | 933           | 692                                 | -115              | 577           | 1196                           | -64               | 1132          |

## 2.4 Return on Equity

The Williams II decision discussion on rate of return is quoted in its entirety below:

"The Commission has concluded that the equity rate of return should be determined on a case-specific basis with reference to the risks and corresponding cost of capital associated with the oil pipeline whose rates are in issue.<sup>48/</sup> Of course, one factor which may be included in any risk analysis is the competition faced by the pipeline.<sup>49/</sup> Any pipeline may try to prove that it is entitled to additional compensation to reflect increased risk or other non-cost factors such as incentives to investment.<sup>50/</sup> This endeavor will yield a nominal rate of return on equity which will then be translated into a real rate by the extraction of inflation pursuant to an index determined in the particular case.<sup>51/</sup> The Commission observed again that rate base and rate of return must "operate together to produce a just and reasonable rate," consequently, the Commission will pay particular attention to the operation of the two elements together in each case.

48/ The Commission expects the cost of equity capital for oil pipelines will be determined by the use of either or both of the market-oriented or comparable earnings standards. Both focus on investor expectations and requirements with respect to earnings.

49/ See Farmers at 1508 m.50.

50/ See Id. at 1495 n. 27, 1503 and 1530.

51/ Moreover, on a case-specific basis, a pipeline will be permitted to argue that its parent company is entitled to compensation for any guarantees of the pipeline's debt. Id. at 1521."

It is worth noting that, while TAPS faces no competition, its initial construction was, as Judge Kane observed, surrounded by an aura of risk.

Table 4 shows the impact of a change from an 8% rate of return on equity to an 11.5% rate of return on equity.

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Table 3  
65% Debt 35% Equity  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |           |       | GAIN WILLIAMS VS CURRENT PROJECTION |           |       | GAIN DDC VS CURRENT PROJECTION |           |       |
|---------------|--------------------------------|-----------|-------|-------------------------------------|-----------|-------|--------------------------------|-----------|-------|
|               | (11)                           | (12)      | (13)  | (14)                                | (15)      | (16)  | (17)                           | (18)      | (19)  |
|               | REFUNDS                        | CASH FLOW | TOTAL | REFUNDS                             | CASH FLOW | TOTAL | REFUNDS                        | CASH FLOW | TOTAL |
| 0.0%          | 209                            | 1225      | 1434  | 4102                                | -783      | 3319  | 5864                           | -722      | 5142  |
| 2.0%          | 209                            | 1136      | 1345  | 3171                                | -522      | 2649  | 4548                           | -446      | 4102  |
| 4.0%          | 209                            | 1046      | 1255  | 2463                                | -352      | 2111  | 3534                           | -278      | 3256  |
| 6.0%          | 209                            | 962       | 1171  | 1923                                | -241      | 1682  | 2758                           | -174      | 2584  |
| 8.0%          | 209                            | 885       | 1094  | 1506                                | -167      | 1341  | 2163                           | -110      | 2053  |
| 10.0%         | 209                            | 815       | 1024  | 1188                                | -117      | 1071  | 1704                           | -70       | 1634  |
| 12.0%         | 209                            | 753       | 962   | 940                                 | -83       | 857   | 1348                           | -44       | 1304  |

35% Debt 65% Equity  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |           |       | GAIN WILLIAMS VS CURRENT PROJECTION |           |       | GAIN DDC VS CURRENT PROJECTION |           |       |
|---------------|--------------------------------|-----------|-------|-------------------------------------|-----------|-------|--------------------------------|-----------|-------|
|               | (10)                           | (11)      | (12)  | (13)                                | (14)      | (15)  | (16)                           | (17)      | (18)  |
|               | REFUNDS                        | CASH FLOW | TOTAL | REFUNDS                             | CASH FLOW | TOTAL | REFUNDS                        | CASH FLOW | TOTAL |
| 0.0%          | 209                            | 1225      | 1434  | 2357                                | -1305     | 1052  | 4861                           | -600      | 4061  |
| 2.0%          | 209                            | 1136      | 1345  | 1822                                | -860      | 942   | 3758                           | -501      | 3257  |
| 4.0%          | 209                            | 1046      | 1255  | 1416                                | -601      | 815   | 2919                           | -317      | 2602  |
| 6.0%          | 209                            | 962       | 1171  | 1105                                | -416      | 689   | 2277                           | -202      | 2077  |
| 8.0%          | 209                            | 885       | 1094  | 867                                 | -291      | 576   | 1787                           | -120      | 1667  |
| 10.0%         | 209                            | 815       | 1025  | 683                                 | -206      | 477   | 1408                           | -84       | 1324  |
| 12.0%         | 209                            | 753       | 962   | 540                                 | -147      | 393   | 1114                           | -55       | 1059  |

Table 3 shows the potential impact of a change from 65/35 debt/equity to 35/65 debt equity with all other variables held constant.

accelerated depreciation such as unit of throughput is desirable. The primary problem with using unit of throughput is that some schedule of deemed through put must be determined and the advantages to the State will depend upon the nature of this schedule. Table 5 shows the impact of a switch from straight line to unit of throughput. The throughput schedule used is a combination of the Department of Revenue and Department of Natural Resources Production estimates as of June 1985.

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Table 5  
Straight Line Depreciation  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DOC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1225             | 1434         | 2684                                | -1103            | 1581         | 5038                           | -789             | 4249         |
| 2.0%          | 209                            | 1136             | 1345         | 2075                                | -742             | 1333         | 3895                           | -493             | 3402         |
| 4.0%          | 209                            | 1046             | 1255         | 1612                                | -506             | 1106         | 3026                           | -312             | 2714         |
| 6.0%          | 209                            | 962              | 1171         | 1258                                | -350             | 908          | 2362                           | -198             | 2164         |
| 8.0%          | 209                            | 885              | 1094         | 987                                 | -244             | 743          | 1853                           | -127             | 1726         |
| 10.0%         | 209                            | 815              | 1024         | 777                                 | -173             | 604          | 1459                           | -82              | 1377         |
| 12.0%         | 209                            | 753              | 962          | 615                                 | -123             | 492          | 1155                           | -54              | 1101         |

Unit of Throughput Depreciation  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTIC |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|-------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS               | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 2416                                | -271              | 2145          | 5070                          | 123               | 5193          |
| 2.0%          | 209                            | 1136              | 1345          | 1868                                | -179              | 1689          | 3920                          | 126               | 4046          |
| 4.0%          | 209                            | 1046              | 1255          | 1451                                | -120              | 1331          | 3045                          | 114               | 3159          |
| 6.0%          | 209                            | 962               | 1171          | 1133                                | -81               | 1052          | 2377                          | 98                | 2475          |
| 8.0%          | 209                            | 885               | 1094          | 888                                 | -55               | 833           | 1864                          | 81                | 1945          |
| 10.0%         | 209                            | 815               | 1025          | 700                                 | -38               | 662           | 1469                          | 66                | 1535          |
| 12.0%         | 209                            | 753               | 962           | 554                                 | -27               | 527           | 1162                          | 53                | 1215          |

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Table 4  
8% Return on Equity  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (11)<br>REFUNDS                | (12)<br>CASH FLOW | (13)<br>TOTAL | (14)<br>REFUNDS                     | (15)<br>CASH FLOW | (16)<br>TOTAL | (17)<br>REFUNDS                | (18)<br>CASH FLOW | (19)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 3915                                | -972              | 2943          | 5918                           | -723              | 5095          |
| 2.0%          | 209                            | 1136              | 1345          | 3026                                | -650              | 2376          | 4499                           | -447              | 4051          |
| 4.0%          | 209                            | 1046              | 1255          | 2351                                | -440              | 1911          | 3494                           | -279              | 3215          |
| 6.0%          | 209                            | 962               | 1171          | 1836                                | -302              | 1534          | 2728                           | -175              | 2553          |
| 8.0%          | 209                            | 885               | 1094          | 1440                                | -210              | 1230          | 2139                           | -110              | 2029          |
| 10.0%         | 209                            | 815               | 1024          | 1134                                | -147              | 987           | 1695                           | -70               | 1615          |
| 12.0%         | 209                            | 753               | 962           | 897                                 | -105              | 792           | 1333                           | -44               | 1289          |

11.5% Return on Equity  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 2684                                | -1103             | 1581          | 5038                           | -789              | 4249          |
| 2.0%          | 209                            | 1136              | 1345          | 2075                                | -742              | 1333          | 3695                           | -493              | 3402          |
| 4.0%          | 209                            | 1046              | 1255          | 1612                                | -506              | 1106          | 3026                           | -312              | 2714          |
| 6.0%          | 209                            | 962               | 1171          | 1253                                | -350              | 908           | 2362                           | -198              | 2164          |
| 8.0%          | 209                            | 885               | 1094          | 987                                 | -244              | 742           | 1853                           | -127              | 1726          |
| 10.0%         | 209                            | 815               | 1025          | 777                                 | -175              | 604           | 1459                           | -82               | 1377          |
| 12.0%         | 209                            | 753               | 962           | 615                                 | -123              | 492           | 1155                           | -54               | 1101          |

2.5 Depreciation Method

Early on in the TAPS litigation the parties agreed, by stipulation, to use of straight line depreciation. However, it is entirely possible to reopen this issue. Thus the State may determine that some form of

## 2.7 Debt Refinancing

It may seem strange that the State should care whether the TAPS owners pay off their outstanding debt and convert to all equity. The reason is the way Williams II treats the tax consequences of interest in the rate making methodology. FERC says that "The usual method is to multiply the company's weighted cost of debt times its rate base. This will not work for oil pipelines. This is so because under the TOC methodology adopted in this opinion the rate base includes an equity write-up. The Commission holds, therefore, that oil pipelines should use their actual interest expense."<sup>4/</sup>

Thus the shippers and therefore the State receive some of the benefit of the interest deduction. Table 7 shows that the potential impact on state revenues is large.

Table 7

### No Refinancing of Debt

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSN VS CURRENT PROJECTION |       |       | GAIN WILLIAMS VS CURRENT PROJECTION |       |       | GAIN OGC VS CURRENT PROJECTION |       |       |
|---------------|--------------------------------|-------|-------|-------------------------------------|-------|-------|--------------------------------|-------|-------|
|               | (11)                           | (12)  | (13)  | (14)                                | (15)  | (16)  | (17)                           | (18)  | (19)  |
|               | REFUNDS CASH FLOW              | TOTAL | TOTAL | REFUNDS CASH FLOW                   | TOTAL | TOTAL | REFUNDS CASH FLOW              | TOTAL | TOTAL |
| 0.0%          | 209                            | 1225  | 1434  | 2184                                | -1193 | 1581  | 5038                           | -789  | 4249  |
| 2.0%          | 209                            | 1156  | 1365  | 2075                                | -742  | 1333  | 2872                           | -493  | 3369  |
| 4.0%          | 209                            | 1086  | 1295  | 1612                                | -506  | 1106  | 2026                           | -312  | 2714  |
| 6.0%          | 209                            | 962   | 1171  | 1228                                | -350  | 878   | 2362                           | -190  | 2164  |
| 8.0%          | 209                            | 835   | 1046  | 987                                 | -244  | 743   | 1853                           | -127  | 1726  |
| 10.0%         | 209                            | 815   | 1026  | 777                                 | -173  | 604   | 1459                           | -82   | 1377  |
| 12.0%         | 209                            | 753   | 962   | 615                                 | -103  | 492   | 1155                           | -54   | 1101  |

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### Full Refinancing of Debt

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSN VS CURRENT PROJECTION |       |       | GAIN WILLIAMS VS CURRENT PROJECTION |       |                   | GAIN OGC VS CURRENT PROJECTION |       |      |
|---------------|--------------------------------|-------|-------|-------------------------------------|-------|-------------------|--------------------------------|-------|------|
|               | (11)                           | (12)  | (13)  | (14)                                | (15)  | (16)              | (17)                           | (18)  |      |
|               | REFUNDS CASH FLOW              | TOTAL | TOTAL | REFUNDS CASH FLOW                   | TOTAL | REFUNDS CASH FLOW | TOTAL                          | TOTAL |      |
| 0.0%          | 209                            | 1225  | 1434  | 2178                                | -1127 | 1043              | 4398                           | -871  | 3527 |
| 2.0%          | 209                            | 1156  | 1365  | 1683                                | -767  | 916               | 2100                           | -552  | 2548 |
| 4.0%          | 209                            | 1086  | 1295  | 1308                                | -528  | 780               | 2641                           | -353  | 2288 |
| 6.0%          | 209                            | 962   | 1171  | 1071                                | -363  | 658               | 2362                           | -229  | 2023 |

## 2.6 Suretyship Premium

This issue arises from footnote 51 (see 2.4 above) of the Williams decision as well as the Williams II treatment of debt financing. In footnote 51 FERC went out of its way to point out the availability of return on guaranteed debt. This seems to make little real sense until you realize that the Williams II decision allows NO return on debt. Thus a company that borrows money to finance a regulated pipeline cannot earn any return on the portion financed with debt. The company is in the position of simply collecting money to pay its bond holders. Table 6 shows the impact of a change from 0 to 2% suretyship premium

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Table 6  
0 Suretyship Premium  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DOC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1472             | 1681         | 3049                                | -1103            | 1946         | 5776                           | -789             | 4987         |
| 2.0%          | 209                            | 1372             | 1581         | 2357                                | -742             | 1615         | 4465                           | -493             | 3972         |
| 4.0%          | 209                            | 1273             | 1482         | 1831                                | -506             | 1325         | 3469                           | -312             | 3157         |
| 6.0%          | 209                            | 1179             | 1388         | 1430                                | -350             | 1080         | 2708                           | -198             | 2510         |
| 8.0%          | 207                            | 1094             | 1303         | 1121                                | -244             | 877          | 2124                           | -127             | 1997         |
| 10.0%         | 208                            | 1016             | 1225         | 683                                 | -173             | 710          | 1673                           | -32              | 1591         |
| 12.0%         | 209                            | 746              | 1155         | 699                                 | -123             | 576          | 1324                           | -54              | 1270         |

2% Suretyship Premium  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1472              | 1681          | 2632                                | -1113             | 1519          | 5776                           | -789              | 4987          |
| 2.0%          | 209                            | 1372              | 1581          | 2035                                | -753              | 1282          | 4465                           | -493              | 3972          |
| 4.0%          | 207                            | 1273              | 1480          | 1581                                | -514              | 1067          | 3469                           | -312              | 3157          |
| 6.0%          | 209                            | 1179              | 1388          | 1224                                | -355              | 869           | 2708                           | -198              | 2510          |
| 8.0%          | 209                            | 1094              | 1303          | 968                                 | -248              | 720           | 2124                           | -127              | 1997          |
| 10.0%         | 208                            | 1016              | 1225          | 767                                 | -176              | 591           | 1673                           | -32               | 1591          |

up its rights to retroactive adjustments. In some contracts the State has specifically retained these rights. In some contracts the language is unclear or mute on the subject.

The problem with severance taxes exists on two levels. First there is a question in some cases of who owes the taxes. Refunds go to shippers, severance taxes are levied on producers. To the extent that shippers and producers differ a problem may exist. Of course, when the shipper and producer are different divisions of the same parent the State can argue that the shipper must pay for the benefit of the producer. At the second level the severance tax issue results from the Alaska statute of limitation for tax matters (AS 43.05.260). This limitation is arguably offset by Regulation 15 AAC 55.200, which the memo concludes is very probably enforceable. However, the memorandum further concludes that it is unlikely the State will prevail in an attempt to obtain severance tax increases based upon any interest increases awarded by FERC to shippers.

Table 8 shows the difference in State revenues resulting from complete refunds vs. no refunds. This table assumes that if there is a

## 2.8 Collectability of Refunds

This is perhaps the most frustrating of all the issues surrounding the settle or litigate question. It is frustrating not because it is particularly complex, but because it exists as an issue at all. The State began the TAPS litigation because we felt the tariffs filed in 1977 were unjustly high. Since 1977 TAPS tariffs have been collected subject to refunds. If the collected tariffs are determined to be unjust and unreasonable and the final tariffs are lower, the refunds will go to those who paid the tariffs. In a memorandum on the collectability question dated November 7, 1984 the State's Outside Council outlines the State's position on those refunds as follows:

The State will contend that a tariff refund causes a commensurate retroactive increase in the wellhead value of Alaskan oil. The State will argue that: (1) as to non-royalty oil, it is entitled to assess a severance tax on the amount refunded because it represents a retroactive increase in the value of previously extracted oil; and (2) as to royalty oil, it is entitled to the entire refund paid to royalty oil purchasers because the refund represents the increased value of royalty oil retroactive to the time of purchase.

The November 7 memorandum examines the relevant issues, statutes, regulations and royalty oil contracts and concludes "It should be clear from this memorandum, however, that the correctness of the State's claims to additional severance taxes and royalty oil payments, plus interest thereon can face a number of substantial obstacles in many circumstances." This memo is included as Appendix F. The problem with royalty oil centers around the language of the individual royalty oil contracts. In some contracts the State has specifically agreed to give

## 2.10 Exclusion from Rate Base

This is the primary issue of Phase II of the TAPS rate case. The question is how much, if any, of the cost of construction should be excluded from the rate base because it was incurred imprudently. The state contends that nearly 2 billion dollars falls into this category. Table 10 shows the impact on state revenues of a change from 0 exclusion to a \$1 billion exclusion.

Table 10  
0 Phase II Exclusion  
\$ 1985 (000,000)

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| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DOC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1472             | 1681         | 2501                                | -1217            | 1284         | 5251                           | -929             | 4322         |
| 2.0%          | 209                            | 1372             | 1581         | 1933                                | -820             | 1113         | 4059                           | -589             | 3470         |
| 4.0%          | 209                            | 1273             | 1482         | 1502                                | -560             | 942          | 3154                           | -377             | 2777         |
| 6.0%          | 209                            | 1179             | 1388         | 1172                                | -388             | 784          | 2462                           | -244             | 2218         |
| 8.0%          | 209                            | 1094             | 1303         | 919                                 | -271             | 648          | 1931                           | -160             | 1771         |
| 10.0%         | 209                            | 1016             | 1225         | 724                                 | -192             | 532          | 1521                           | -106             | 1415         |
| 12.0%         | 209                            | 946              | 1155         | 573                                 | -137             | 436          | 1203                           | -70              | 1133         |

\$ 1 Billion Phase II Exclusion  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1472              | 1681          | 3700                                | -967              | 2733          | 6417                           | -618              | 5799          |
| 2.0%          | 209                            | 1372              | 1581          | 2860                                | -650              | 2210          | 4960                           | -377              | 4583          |
| 4.0%          | 209                            | 1273              | 1482          | 2222                                | -442              | 1780          | 3854                           | -231              | 3623          |
| 6.0%          | 209                            | 1179              | 1388          | 1735                                | -304              | 1431          | 3008                           | -142              | 2866          |
| 8.0%          | 209                            | 1094              | 1303          | 1361                                | -212              | 1149          | 2359                           | -68               | 2291          |
| 10.0%         | 209                            | 1016              | 1225          | 1072                                | -150              | 922           | 1859                           | -54               | 1805          |
| 12.0%         | 209                            | 946               | 1155          | 849                                 | -107              | 741           | 1471                           | -33               | 1438          |

## 2.9 Interest on Refunds

A separate issue revolves around whether the State has the ability to collect interest on any refunds we may obtain. To an extent this question hinges upon when any increased severance taxes become legally due. If they are due as of the date of the final decision then at best interest only begins accruing as of that date. If, on the other hand, they are due in the year the crude was first produced interest may begin accruing as of that year. This, however, once again raises the specter of statute of limitation arguments.

Table 9 shows the difference in state revenue between full interest from the year of production (without regarding to statute of limitations considerations) and no interest on monies prior to 1985.

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Table 9  
Full Interest  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TEN VS CURRENT PROJECTION |       |      | GAIN WILLIAMS VS CURRENT PROJECTION |       |      | GAIN CCC VS CURRENT PROJECTION |       |      |
|---------------|--------------------------------|-------|------|-------------------------------------|-------|------|--------------------------------|-------|------|
|               | (10)                           | (11)  | (12) | (13)                                | (14)  | (15) | (16)                           | (17)  | (18) |
|               | REFUNDS CASH FLOW              | TOTAL |      | REFUNDS CASH FLOW                   | TOTAL |      | REFUNDS CASH FLOW              | TOTAL |      |
| 0.00          | 219                            | 1225  | 1428 | 2249                                | -1163 | 1946 | 5776                           | -759  | 4937 |
| 2.00          | 219                            | 1179  | 1295 | 2257                                | -742  | 1515 | 4435                           | -493  | 3972 |
| 4.00          | 219                            | 1146  | 1265 | 1931                                | -516  | 1225 | 3469                           | -312  | 3157 |
| 6.00          | 219                            | 762   | 1171 | 1439                                | -250  | 1129 | 2720                           | -148  | 2510 |
| 8.00          | 219                            | 555   | 1076 | 1121                                | -204  | 877  | 2121                           | -127  | 1997 |
| 10.00         | 219                            | 515   | 1023 | 889                                 | -173  | 710  | 1573                           | -82   | 1591 |
| 12.00         | 219                            | 53    | 762  | 598                                 | -122  | 525  | 1224                           | -54   | 1270 |

0 Interest  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TEN VS CURRENT PROJECTION |       |      | GAIN WILLIAMS VS CURRENT PROJECTION |       |      | GAIN CCC VS CURRENT PROJECTION |       |      |
|---------------|--------------------------------|-------|------|-------------------------------------|-------|------|--------------------------------|-------|------|
|               | (19)                           | (20)  | (21) | (22)                                | (23)  | (24) | (25)                           | (26)  | (27) |
|               | REFUNDS CASH FLOW              | TOTAL |      | REFUNDS CASH FLOW                   | TOTAL |      | REFUNDS CASH FLOW              | TOTAL |      |
| 0.00          | 219                            | 1225  | 1428 | 2154                                | -1193 | 1201 | 5223                           | -739  | 4419 |
| 2.00          | 219                            | 1176  | 1295 | 2075                                | -742  | 1222 | 3892                           | -492  | 3412 |
| 4.00          | 219                            | 1146  | 1255 | 1612                                | -516  | 1116 | 3226                           | -312  | 2910 |
| 6.00          | 219                            | 762   | 1171 | 1223                                | -256  | 968  | 2762                           | -198  | 2510 |
| 8.00          | 219                            | 555   | 1076 | 897                                 | -204  | 743  | 2123                           | -127  | 1996 |
| 10.00         | 219                            | 515   | 1023 | 777                                 | -173  | 604  | 1459                           | -82   | 1377 |
| 12.00         | 219                            | 53    | 762  | 515                                 | -122  | 492  | 1155                           | -54   | 1121 |

10 years or 20 years. Table 2 gives an example of the potential impact on state revenues of a delay of 3 years versus a delay of 12 years in reaching a litigated decision (note that all other variables are held constant to develop this table).

Table 2

Nov. 14

3 Year Delay

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DOC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1225             | 1434         | 2940                                | -986             | 1954         | 3293                           | 1011             | 4304         |
| 2.0%          | 209                            | 1136             | 1345         | 2716                                | -619             | 2097         | 3043                           | 926              | 3969         |
| 4.0%          | 209                            | 1046             | 1255         | 2513                                | -381             | 2132         | 2815                           | 836              | 3651         |
| 6.0%          | 209                            | 962              | 1171         | 2329                                | -225             | 2103         | 2609                           | 748              | 3357         |
| 8.0%          | 209                            | 885              | 1094         | 2161                                | -124             | 2037         | 2421                           | 667              | 3088         |
| 10.0%         | 209                            | 815              | 1024         | 2008                                | -57              | 1951         | 2247                           | 594              | 2843         |
| 12.0%         | 209                            | 753              | 962          | 1868                                | -14              | 1854         | 2093                           | 529              | 2622         |

12 Year Delay

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DOC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 3049                                | -1096             | 1953          | 4527                           | -223              | 4304          |
| 2.0%          | 209                            | 1136              | 1345          | 2857                                | -737              | 1620          | 3500                           | -139              | 3361          |
| 4.0%          | 209                            | 1046              | 1255          | 1831                                | -501              | 1330          | 2719                           | -87               | 2632          |
| 6.0%          | 209                            | 962               | 1171          | 1430                                | -346              | 1084          | 2122                           | -55               | 2067          |
| 8.0%          | 209                            | 885               | 1094          | 1121                                | -241              | 880           | 1865                           | -35               | 1830          |
| 10.0%         | 209                            | 815               | 992           | 883                                 | -170              | 713           | 1311                           | -22               | 1289          |
| 12.0%         | 209                            | 753               | 962           | 699                                 | -121              | 578           | 1037                           | -14               | 1023          |

of the actual calculations are automatic. Regulated companies may file for a new allowed earnings (and tariff) and request a return whenever economic conditions warrant a change. However rate changes have historically tended to lag behind actual economic changes. Further the regulatory process is not immune to the pressures that are brought to bear. Shippers or consumers will always oppose rate increases while the regulated company will always attempt to minimize rate decreases. Therefore, the choice of a rate making methodology does tend to make a difference. Further, the choice of methodology affects the yearly cash flow to the companies (and consequently to the State). Under DOC allowed earnings (and therefore tariffs) are higher in the early years than under TOC and this situation reverses itself in the sixth year when earnings (and tariffs) become lower.

## 2.2 Time Before Decision

The second variable that affects the settle/litigate question is the time lag before completion of the rate making case. Estimates of time to completion under the litigation option range from a low of 5 to 6 years to a high of 14 or more years. Under the settlement option revenues (in the form of refunds and increased severance taxes and royalties from lower tariffs and wellheads) begin to flow to the State in 1986. Clearly, the longer the State has to wait for the revenue stream to begin, the less valuable that income stream becomes. Thus under the litigation option it makes a difference whether the decision maker believes a final decision (FERC plus all appeals) will come in 3 years.

It is worth noting that, while TAPS faces no competition Judge Kane observed that its initial construction was surrounded by an aura of risk.

Table 3 shows the impact of a change from an 8% rate of return on equity to an 11.5% rate of return on equity.

Table 3  
8% Return on Equity  
\$ 1985 (000,000)

Nov. 14

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DCC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1225             | 1434         | 3963                                | -1010            | 2953         | 3539                           | 400              | 4939         |
| 2.0%          | 209                            | 1136             | 1345         | 3450                                | -672             | 2778         | 3951                           | 272              | 4323         |
| 4.0%          | 209                            | 1046             | 1255         | 3312                                | -452             | 2560         | 3449                           | 334              | 3783         |
| 6.0%          | 209                            | 962              | 1171         | 2636                                | -307             | 2329         | 3019                           | 295              | 3314         |
| 8.0%          | 209                            | 885              | 1094         | 2313                                | -210             | 2103         | 2648                           | 256              | 2904         |
| 10.0%         | 209                            | 815              | 1024         | 2034                                | -145             | 1889         | 2329                           | 222              | 2551         |
| 12.0%         | 209                            | 753              | 962          | 1793                                | -100             | 1693         | 2053                           | 191              | 2244         |

11.5% Return on Equity  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DCC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 2593                                | -1496             | 1097          | 3570                           | 242               | 3812          |
| 2.0%          | 209                            | 1136              | 1345          | 2257                                | -1047             | 1210          | 3108                           | 248               | 3356          |
| 4.0%          | 209                            | 1046              | 1255          | 1970                                | -744              | 1226          | 2713                           | 227               | 2950          |
| 6.0%          | 209                            | 962               | 1171          | 1724                                | -537              | 1187          | 2374                           | 216               | 2590          |
| 8.0%          | 209                            | 885               | 1094          | 1513                                | -394              | 1119          | 2083                           | 193               | 2276          |
| 10.0%         | 209                            | 815               | 992           | 1331                                | -292              | 1039          | 1872                           | 170               | 2042          |
| 12.0%         | 209                            | 753               | 962           | 1173                                | -220              | 953           | 1515                           | 149               | 1664          |

Note that at a real discount rate of 0 the total revenues remain unchanged (column 6 compared with 15 and 9 compared with 18). However, once a real discount rate is applied the value of monies received farther in the future begins to fall. Thus if the decisionmaker believes a quick decision will be forthcoming the litigation alternative is relatively more attractive than if the decisionmaker expects a litigated outcome to take a long time.

### 2.3 Return on Equity

The Williams II decision discussion on rate of return is quoted in its entirety below:

"The Commission has concluded that the equity rate of return should be determined on a case-specific basis with reference to the risks and corresponding cost of capital associated with the oil pipeline whose rates are in issue.<sup>48/</sup> Of course, one factor which may be included in any risk analysis is the competition faced by the pipeline.<sup>49/</sup> Any pipeline may try to prove that it is entitled to additional compensation to reflect increased risk or other non-cost factors such as incentives to investment.<sup>50/</sup> This endeavor will yield a nominal rate of return on equity which will then be translated into a real rate by the extraction of inflation pursuant to an index determined in the particular case.<sup>51/</sup> The Commission observed again that rate base and rate of return must "operate together to produce a just and reasonable rate," consequently, the Commission will pay particular attention to the operation of the two elements together in each case.

48/ The Commission expects the cost of equity capital for oil pipelines will be determined by the use of either or both of the market-oriented or comparable earnings standards. Both focus on investor expectations and requirements with respect to earnings.

49/ See *Farmers* at 1508 n.50.

50/ See *id.* at 1495 n. 27, 1503 and 1530.

51/ Moreover, on a case-specific basis, a pipeline will be permitted to argue that its parent company is entitled to compensation for any guarantees of the pipeline's debt. *Id.* at 1521."

## 2.5 Debt/Equity Ratio

The debt/equity ratio makes a difference because the treatment of debt and equity differs in rate making methodologies. In Williams II FERC ruled "...that a pipeline which has issued no long-term debt or which issues long term debt to its parent or which issues long term debt guaranteed by its parent to outside investors should use its parent's actual capital structure"<sup>3/</sup> (emphasis added). This seems to imply that FERC has ruled on the appropriate debt/equity ratio for use by oil pipelines. However, clearly this can be changed on appeal and equally clearly the State may still argue for a more favorable (to the State) outcome. Since TAPS was built with 90% debt financing there is potentially a lot at stake in this argument.

## 2.4 Suretyship Premium

This issue arises from footnote 51 (see 2.3 above) of the Williams decision as well as the Williams II treatment of debt financing. In footnote 51 FERC went out of its way to point out the availability of return on guaranteed debt. The suretyship premium allows the company to earn a return on debt guaranteed by the parent company. Table 4 shows the impact of a change from 0 to 2% suretyship premium

Table 4  
0 Suretyship Premium  
\$ 1985 (000,000)

Nov. 14

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                  |              | GAIN WILLIAMS VS CURRENT PROJECTION |                  |              | GAIN DDC VS CURRENT PROJECTION |                  |              |
|---------------|--------------------------------|------------------|--------------|-------------------------------------|------------------|--------------|--------------------------------|------------------|--------------|
|               | (1)<br>REFUNDS                 | (2)<br>CASH FLOW | (3)<br>TOTAL | (4)<br>REFUNDS                      | (5)<br>CASH FLOW | (6)<br>TOTAL | (7)<br>REFUNDS                 | (8)<br>CASH FLOW | (9)<br>TOTAL |
| 0.0%          | 209                            | 1225             | 1434         | 2226                                | -1272            | 1954         | 2993                           | 311              | 4304         |
| 2.0%          | 209                            | 1136             | 1345         | 2509                                | -675             | 1834         | 3476                           | 303              | 3779         |
| 4.0%          | 209                            | 1046             | 1255         | 2452                                | -610             | 1642         | 3034                           | 279              | 3313         |
| 6.0%          | 209                            | 962              | 1171         | 2146                                | -432             | 1714         | 2656                           | 251              | 2907         |
| 8.0%          | 209                            | 885              | 1094         | 1852                                | -310             | 1542         | 2330                           | 221              | 2551         |
| 10.0%         | 209                            | 815              | 1024         | 1656                                | -225             | 1431         | 2049                           | 193              | 2242         |
| 12.0%         | 209                            | 753              | 962          | 1459                                | -165             | 1294         | 1806                           | 167              | 1973         |

## 2% Suretyship Premium

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TSM VS CURRENT PROJECTION |                   |               | GAIN WILLIAMS VS CURRENT PROJECTION |                   |               | GAIN DDC VS CURRENT PROJECTION |                   |               |
|---------------|--------------------------------|-------------------|---------------|-------------------------------------|-------------------|---------------|--------------------------------|-------------------|---------------|
|               | (10)<br>REFUNDS                | (11)<br>CASH FLOW | (12)<br>TOTAL | (13)<br>REFUNDS                     | (14)<br>CASH FLOW | (15)<br>TOTAL | (16)<br>REFUNDS                | (17)<br>CASH FLOW | (18)<br>TOTAL |
| 0.0%          | 209                            | 1225              | 1434          | 2693                                | -1313             | 1580          | 2993                           | 311               | 4304          |
| 2.0%          | 209                            | 1136              | 1345          | 2519                                | -507              | 1812          | 3476                           | 303               | 3779          |
| 4.0%          | 209                            | 1046              | 1255          | 2199                                | -636              | 1563          | 3034                           | 279               | 3313          |
| 6.0%          | 209                            | 962               | 1171          | 1924                                | -453              | 1471          | 2656                           | 251               | 2907          |
| 8.0%          | 209                            | 885               | 1094          | 1688                                | -327              | 1361          | 2330                           | 221               | 2551          |
| 10.0%         | 209                            | 815               | 992           | 1485                                | -239              | 1246          | 2049                           | 193               | 2242          |
| 12.0%         | 209                            | 753               | 962           | 1309                                | -176              | 1133          | 1806                           | 167               | 1973          |

## 2.6 Depreciation Method

Early in the TAPS litigation the parties agreed, by stipulation, to use of straight line depreciation. However, it may be possible to reopen this issue. Thus the State may determine that some form of accelerated depreciation such as unit of throughput is desirable. The primary problem with using unit of throughput is that some schedule of deemed throughput must be determined and the advantages to the State will depend upon the nature of this schedule. Table 6 shows the impact of a switch from straight line to unit of throughput. The throughput schedule used is a combination of the Department of Revenue and Department of Natural Resources Production estimates as of June 1985.

*Nov. 14*

Table 6  
Straight Line Depreciation  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TER VS CURRENT PROJECTION |       |      | GAIN WILLIAMS VS CURRENT PROJECTION |       |      | GAIN COC VS CURRENT PROJECTION |       |      |
|---------------|--------------------------------|-------|------|-------------------------------------|-------|------|--------------------------------|-------|------|
|               | (10)                           | (11)  | (12) | (13)                                | (14)  | (15) | (16)                           | (17)  | (18) |
|               | REFUNDS CASH FLOW              | TOTAL |      | REFUNDS CASH FLOW                   | TOTAL |      | REFUNDS CASH FLOW              | TOTAL |      |
| 0.0%          | 209                            | 1225  | 1434 | 2226                                | -1272 | 1954 | 2575                           | 311   | 1704 |
| 2.0%          | 209                            | 1126  | 1335 | 2309                                | -275  | 1934 | 2476                           | 263   | 2739 |
| 4.0%          | 209                            | 1046  | 1255 | 2452                                | -616  | 1836 | 2024                           | 274   | 2513 |
| 6.0%          | 209                            | 962   | 1171 | 2246                                | -432  | 1714 | 2025                           | 251   | 2027 |
| 8.0%          | 209                            | 885   | 1094 | 1622                                | -370  | 1252 | 2320                           | 221   | 1521 |
| 10.0%         | 209                            | 815   | 992  | 1626                                | -225  | 1401 | 2049                           | 193   | 2212 |
| 12.0%         | 209                            | 753   | 922  | 1439                                | -165  | 1274 | 1605                           | 167   | 1972 |

Unit of Throughput Depreciation  
\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TER VS CURRENT PROJECTION |       |      | GAIN WILLIAMS VS CURRENT PROJECTION |       |      | GAIN COC VS CURRENT PROJECTION |       |      |
|---------------|--------------------------------|-------|------|-------------------------------------|-------|------|--------------------------------|-------|------|
|               | (11)                           | (12)  | (13) | (14)                                | (15)  | (16) | (17)                           | (18)  | (19) |
|               | REFUNDS CASH FLOW              | TOTAL |      | REFUNDS CASH FLOW                   | TOTAL |      | REFUNDS CASH FLOW              | TOTAL |      |
| 0.0%          | 209                            | 1225  | 1434 | 2177                                | -73   | 2104 | 2266                           | 906   | 1470 |
| 2.0%          | 209                            | 1126  | 1345 | 2157                                | -13   | 2144 | 2103                           | 745   | 2848 |
| 4.0%          | 209                            | 1046  | 1255 | 1235                                | 20    | 1255 | 2740                           | 613   | 1521 |
| 6.0%          | 209                            | 962   | 1171 | 1647                                | 37    | 1684 | 2770                           | 526   | 2576 |
| 8.0%          | 209                            | 885   | 1094 | 1445                                | 44    | 1489 | 2786                           | 414   | 2459 |
| 10.0%         | 209                            | 815   | 1024 | 1271                                | 46    | 1317 | 1629                           | 349   | 2178 |
| 12.0%         | 209                            | 753   | 952  | 1121                                | 45    | 1166 | 1612                           | 291   | 1903 |

Nov. 14

Table 5

65% Debt 35% Equity

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TEM VS CURRENT PROJECTION |           |       | GAIN WILLIAMS VS CURRENT PROJECTION |           |       | GAIN BCC VS CURRENT PROJECTION |           |       |
|---------------|--------------------------------|-----------|-------|-------------------------------------|-----------|-------|--------------------------------|-----------|-------|
|               | (1)                            | (2)       | (3)   | (4)                                 | (5)       | (6)   | (7)                            | (8)       | (9)   |
|               | REFUNDS                        | CASH FLOW | TOTAL | REFUNDS                             | CASH FLOW | TOTAL | REFUNDS                        | CASH FLOW | TOTAL |
| 0.0%          | 209                            | 1225      | 1434  | 4145                                | -620      | 3526  | 4578                           | 414       | 5112  |
| 2.0%          | 209                            | 1136      | 1345  | 3609                                | -385      | 3223  | 4090                           | 280       | 4470  |
| 4.0%          | 209                            | 1046      | 1255  | 3150                                | -239      | 2911  | 3570                           | 243       | 3913  |
| 6.0%          | 209                            | 952       | 1171  | 2757                                | -145      | 2612  | 3124                           | 201       | 3425  |
| 8.0%          | 209                            | 855       | 1094  | 2419                                | -85       | 2334  | 2741                           | 152       | 3003  |
| 10.0%         | 209                            | 755       | 1024  | 2127                                | -47       | 2080  | 2411                           | 106       | 2537  |
| 12.0%         | 209                            | 753       | 962   | 1875                                | -23       | 1852  | 2105                           | 194       | 2319  |

35% Debt 65% Equity

\$ 1985 (000,000)

| DISCOUNT RATE | GAIN TEM VS CURRENT PROJECTION |           |       | GAIN WILLIAMS VS CURRENT PROJECTION |           |       | GAIN BCC VS CURRENT PROJECTION |           |       |
|---------------|--------------------------------|-----------|-------|-------------------------------------|-----------|-------|--------------------------------|-----------|-------|
|               | (10)                           | (11)      | (12)  | (13)                                | (14)      | (15)  | (16)                           | (17)      | (18)  |
|               | REFUNDS                        | CASH FLOW | TOTAL | REFUNDS                             | CASH FLOW | TOTAL | REFUNDS                        | CASH FLOW | TOTAL |
| 0.0%          | 209                            | 1225      | 1434  | 2541                                | -1751     | 790   | 2487                           | 238       | 3725  |
| 2.0%          | 209                            | 1136      | 1345  | 2212                                | -1233     | 979   | 2036                           | 245       | 3281  |
| 4.0%          | 209                            | 1046      | 1255  | 1931                                | -683      | 1048  | 2650                           | 234       | 2884  |
| 6.0%          | 209                            | 952       | 1171  | 1690                                | -642      | 1048  | 2319                           | 214       | 2533  |
| 8.0%          | 209                            | 855       | 1094  | 1483                                | -474      | 1009  | 2025                           | 192       | 2227  |
| 10.0%         | 209                            | 815       | 992   | 1304                                | -355      | 949   | 1790                           | 169       | 1959  |
| 12.0%         | 209                            | 753       | 962   | 1147                                | -237      | 860   | 1578                           | 148       | 1726  |

Table 5 shows the potential impact of a change from 65/35 debt/equity to 35/65 debt equity with all other variables held constant.

Testimony Before the Alaska  
House of Representatives Resources Committee  
on HB 519, HB 541, HB 554, HB 572 and HB 573

Richard A. Fineberg  
March 21, 1990

Mr. Chairman, my name is Richard Fineberg. The committee has received copies of my report on oil and gas revenue disputes, which was prepared under the direction of Representative Navarre.<sup>1</sup> Thank you for the opportunity to testify on the management of revenue disputes between Alaska and its major oil and gas producers.

At this time, the State believes it is owed in oil and gas revenue disputes a sum equal to more than one-half of the Alaska Permanent Fund. The vast majority of this amount represents the difference between the State and a very small number of major producers in reckoning the division of the profits (economic rent) from the North Slope bonanza, plus interest and penalties.

In contrast to the wide discussion of Permanent Fund policies, however, relatively little public attention has focused on the management of Alaska's continuing revenue collection effort. This Administration has taken some steps to improve case management, and to increase legislative involvement in this important area. However, most of the legislative review this subject has received in the last three years has taken place behind closed doors, in hearings involving a small number of people.

The secrecy that surrounds oil and gas revenue disputes derives in large part from two sources: the confidentiality imposed by the assumed right of the taxpayer to a remarkable degree of privacy, and by the broad application of the assumption that litigating strategy requires information to be very closely held. I believe the cloak of confidentiality over oil and gas matters has a corrosive effect on the quality of information that is available to the public, to the legislators who chart and review policy -- and even to the people charged with responsibility for executing that policy. If you review the settlement of the Trans-Alaska Pipeline System (TAPS) rate case -- one of the three major oil and gas

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<sup>1</sup> My interest in this subject stems from work on State budget, revenue and oil and gas issues for the Governor's Office of Management and Budget from 1983 through October 1989. From late 1986 through October 1989 I spent the much of my time dealing with oil and gas revenue disputes. My report on this subjects contains 22 specific recommendations, ten of which are statutory. Most of the bills before you today reflect recommendations in that report.

settlements since 1985 -- you will find a number of rather astonishing confirmations of this thesis.<sup>2</sup>

Policy in this area is made and executed with such secrecy, Mr. Chairman, that if you were to request the Department of Revenue to tell you about one certain settlement, the Department would have to ask you to invite the settling company to be present.

The Commissioner of Natural Resources has created a special settlement team that is working actively to settle the State's royalty litigation, with a \$1.3 billion claim in royalty payments and interest from 1977 through 1986 depending on the outcome. In view of the magnitude of this case, some may find it surprising that there are no procedures in place to insure an independent review of any settlement that might be negotiated.

Nor are any formal review procedures contemplated.

Mr. Chairman, in response to a query from your office, the Commissioner of Natural Resources informed you last week that she has no intention of establishing an independent review procedure for this important case. The Commissioner responded that:

initial review of settlement offers will be undertaken by the settlement team I have appointed. . . . Any recommendations toward settlement for this group [sic.] will be reviewed by the litigation team and its consultants. . . . That team, which has undertaken the most extensive analysis of and aggressive posture toward royalty obligations . . . would provide the most extensive 'second opinion' on proposed settlements or settlement offers.

In other words, the Commissioner intends to rely first on the settling team to review its own settlement and to rely second on the litigating attorneys to blow the whistle if the litigators don't like the settlement. In my estimation, this plan has two basic problems:

First, settlements tend to develop a momentum of their own, as we have seen in the past. This happens because a settling team is liable to become enamored of its own

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<sup>2</sup> Early in 1985, significant facts were omitted from the major briefing document on the settlement. Later that same year, the Governor's final major TAPS decision was briefed with an erroneous document. Subsequently, a set of numbers in that document was quietly revised and the erroneous document was removed from agency files. The mistakes in the briefing document made the settlement seem significantly better than it actually was, in comparison to continued litigation. The Administration refused to release the original document and contended that it was essentially identical to the public document. These nightmarish, Orwellian information gaffe adversely affected key Executive decisions, as well as both Executive and Legislative policy review of what the Department of Law called the largest and most complicated rate-making case in the history of the United States.

settlement, and also because a bureaucratic group that works at length on a project naturally wants to complete that project. With hundreds of millions of dollars riding on disputes with individual companies, independent review -- not review by the settling team -- seems like a wise precaution.

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In both the tax and royalty arenas, to protect the public interest in settlements of this magnitude, I believe, stewardship of Alaska's resources demands codified guidelines for a disinterested, independent review of major settlements.

Mr. Chairman, this is a very unusual area of public policy. If you get a traffic ticket, you pay the penalty or go to court. If you receive a traffic ticket when you are drunk, the penalty is also clear. And if you rack up a specific number of infractions, you lose your license to drive. But if you are one of the small number of taxpaying corporations that habitually underpay their taxes by tens of millions of dollars, year after year, and if you then stonewall the tax auditors, the sanctions are not at all clear. The tax collector and the taxpayer typically negotiate a solution. They do so in the absence of clear statutory guidelines, and in secrecy that erodes the checks and balances that normally safeguard the public interest.

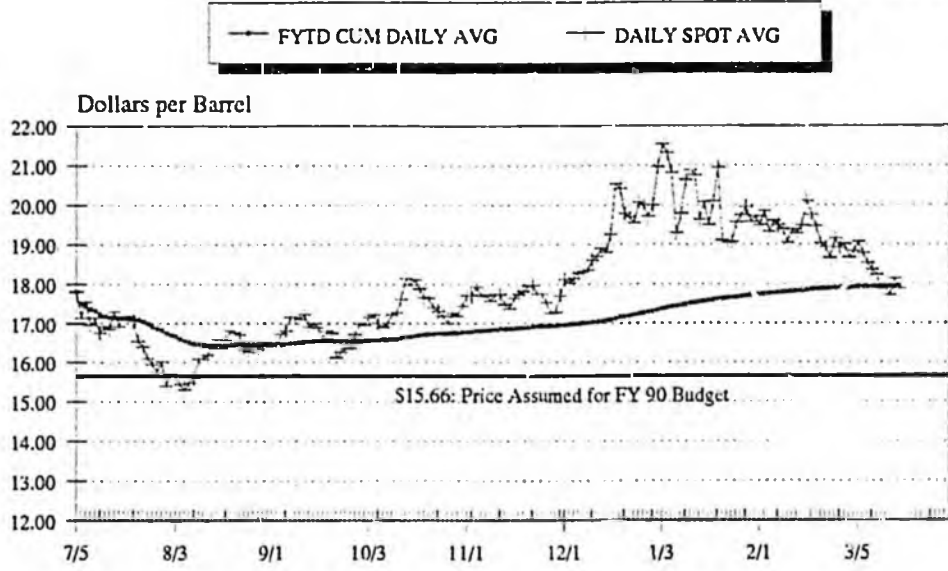
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I will be happy to answer questions now, or after the bills before you today are introduced by their sponsors.

# FY 90 ANS CRUDE PRICES

FYTD Cumulative Daily Spot Average  
vs. Daily Spot Average

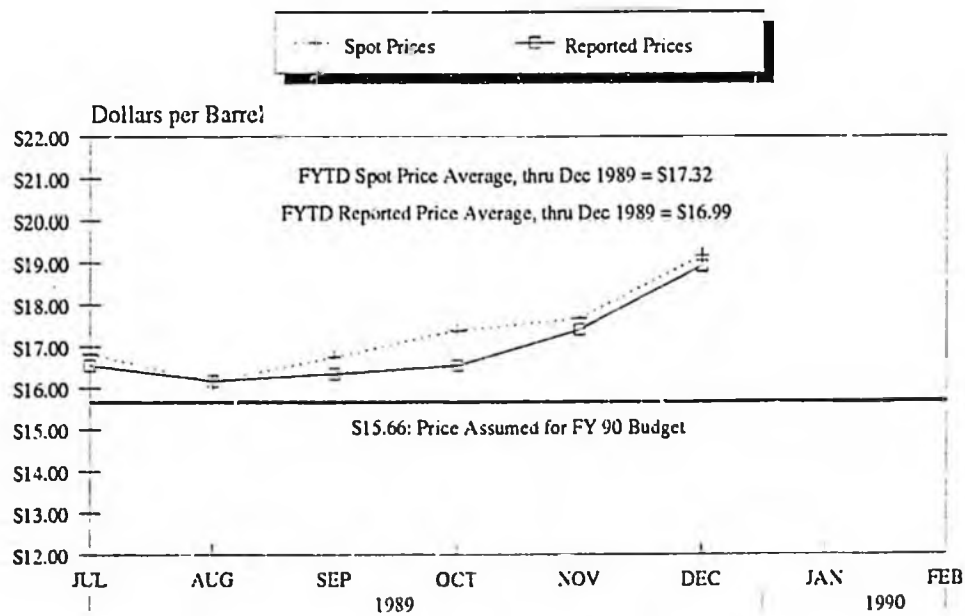
RECEIVED  
ALASKA DEPARTMENT OF REVENUE  
MAY 19 1990  
COMMISSIONER OF REVENUE



(Alaska Department of Revenue, 3/16/90)

# FY 90 ANS CRUDE PRICES

Monthly Weighted Average



(Alaska Department of Revenue, 3/16/90)

**Testimony Before the Alaska  
House of Representatives Resources Committee  
on HB 519, HB 541, HB 554, HB 572 and HB 573**

**Richard A. Fineberg  
March 21, 1990**

Mr. Chairman, my name is Richard Fineberg. The committee has received copies of my report on oil and gas revenue disputes, which was prepared under the direction of Representative Navarre.<sup>1</sup> Thank you for the opportunity to testify on the management of revenue disputes between Alaska and its major oil and gas producers.

At this time, the State believes it is owed in oil and gas revenue disputes a sum equal to more than one-half of the Alaska Permanent Fund. The vast majority of this amount represents the difference between the State and a very small number of major producers in reckoning the division of the profits (economic rent) from the North Slope bonanza, plus interest and penalties.

In contrast to the wide discussion of Permanent Fund policies, however, relatively little public attention has focused on the management of Alaska's continuing revenue collection effort. This Administration has taken some steps to improve case management, and to increase legislative involvement in this important area. However, most of the legislative review this subject has received in the last three years has taken place behind closed doors, in hearings involving a small number of people.

The secrecy that surrounds oil and gas revenue disputes derives in large part from two sources: the confidentiality imposed by the assumed right of the taxpayer to a remarkable degree of privacy, and by the broad application of the assumption that litigating strategy requires information to be very closely held. I believe the cloak of confidentiality over oil and gas matters has a corrosive effect on the quality of information that is available to the public, to the legislators who chart and review policy -- and even to the people charged with responsibility for executing that policy. If you review the settlement of the Trans-Alaska Pipeline System (TAPS) rate case -- one of the three major oil and gas

---

<sup>1</sup> My interest in this subject stems from work on State budget, revenue and oil and gas issues for the Governor's Office of Management and Budget from 1983 through October 1989. From late 1986 through October 1989 I spent the much of my time dealing with oil and gas revenue disputes. My report on this subjects contains 22 specific recommendations, ten of which are statutory. Most of the bills before you today reflect recommendations in that report.

settlements since 1985 -- you will find a number of rather astonishing confirmations of this thesis.<sup>2</sup>

Policy in this area is made and executed with such secrecy, Mr. Chairman, that if you were to request the Department of Revenue to tell you about one certain settlement, the Department would have to ask you to invite the settling company to be present.

The Commissioner of Natural Resources has created a special settlement team that is working actively to settle the State's royalty litigation, with a \$1.3 billion claim in royalty payments and interest from 1977 through 1986 depending on the outcome. In view of the magnitude of this case, some may find it surprising that there are no procedures in place to insure an independent review of any settlement that might be negotiated.

Nor are any formal review procedures contemplated.

Mr. Chairman, in response to a query from your office, the Commissioner of Natural Resources informed you last week that she has no intention of establishing an independent review procedure for this important case. The Commissioner responded that:

initial review of settlement offers will be undertaken by the settlement team I have appointed. . . . Any recommendations toward settlement for this group [sic.] will be reviewed by the litigation team and its consultants. . . . That team, which has undertaken the most extensive analysis of and aggressive posture toward royalty obligations . . . would provide the most extensive 'second opinion' on proposed settlements or settlement offers.

In other words, the Commissioner intends to rely first on the settling team to review its own settlement and to rely second on the litigating attorneys to blow the whistle if the litigators don't like the settlement. In my estimation, this plan has two basic problems:

First, settlements tend to develop a momentum of their own, as we have seen in the past. This happens because a settling team is liable to become enamored of its own

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<sup>2</sup> Early in 1985, significant facts were omitted from the major briefing document on the settlement. Later that same year, the Governor's final major TAPS decision was briefed with an erroneous document. Subsequently, a set of numbers in that document was quietly revised and the erroneous document was removed from agency files. The mistakes in the briefing document made the settlement seem significantly better than it actually was, in comparison to continued litigation. The Administration refused to release the original document and contended that it was essentially identical to the public document. These nightmarish, Orwellian information gaffs adversely affected key Executive decisions, as well as both Executive and Legislative policy review of what the Department of Law called the largest and most complicated rate-making case in the history of the United States.

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What about the so-called "second opinion" by the litigating attorneys? This review will protect the public interest only if the recommendations are heeded. But if the litigating attorneys do not approve the settlement, their wisdom is liable to be dismissed on one of two grounds: "Of course they want to litigate: They're lawyers." Or: "These lawyers just don't want to see their rice bowl broken." The Commissioner's letter to you indicated that the State's litigating attorneys exhibit a most aggressive posture toward royalty obligations.

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It is my hope that in the midst of your busy schedules you will give these measures the attention they deserve. Careful consideration of the proposals before you today can make a significant contribution to improving the manner in which decisions are made in this arena. Few issues are more important to the State's fiscal well-being.

I will be happy to answer questions now, or after the bills before you today are introduced by their sponsors.

What should the State choose for  
Interest rates on taxes due?

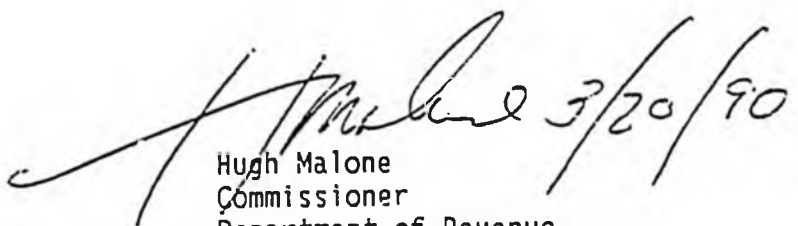
Presently, delinquent taxes pay interest at a fixed rate of 12% simple interest. Generally, this is a great deal less than what a taxpayer would have paid if he borrowed the money at a bank.

I would recommend that the rate on delinquent taxes be tied to the market.

I believe that a floating rate 5% points above the federal reserve rate, as set out in AS 45.45.010(b) would work well for delinquent taxes.

A lower rate, say 3% points above the federal reserve rate, should apply to any refunds. This would give a taxpayer an incentive to get the issue resolved, but would not put the state at risk if a taxpayer overpaid.

A similar differential approach is used by the U.S. Treasury Department.

 3/20/90  
Hugh Malone  
Commissioner  
Department of Revenue

Attachment: (1) Compound interest chart  
(2) Historic Federal Reserve discount rate

COMPOUND INTEREST - AN INCENTIVE TO PAY

\$100,000 + interest from 1/1/80 to 1/1/90.  
 Showing total amounts which would be due at one, 5, and 10 years.

|                                                                                      | <u>1/1/81</u> | <u>1/1/85</u> | <u>1/1/90</u> |
|--------------------------------------------------------------------------------------|---------------|---------------|---------------|
| 12% simple                                                                           | \$112,000     | \$160,000     | \$220,000     |
| 12% compound                                                                         | 112,000       | 176,234       | 310,584       |
| 20% simple                                                                           | 120,000       | 200,000       | 300,000       |
| 20% compound                                                                         | 120,000       | 248,832       | 619,174       |
| Floating Rate 5% above<br>Federal Reserve (AS 45.45.010(h)<br>compounded annually */ | 116,800       | 207,140       | 356,980       |

---

\*/ These amounts were calculated using the following yearly rates for the federal reserve rate and adding 5% to each rate to reach the rate call for in AS 45.45.010(b). These rates are for illustration purposes only:

|                              |                     |
|------------------------------|---------------------|
| Federal Reserve Rate Average | First year @ 11.8   |
| weighted by days for period  | Next 4 years @ 10.4 |
| indicated.                   | Last 5 years @ 6.5  |

See attachment for actual base federal reserve rates during this period.

FEDERAL RESERVE BANK OF SAN FRANCISCO  
 101 MARKET STREET, SAN FRANCISCO, CALIFORNIA 94105

"DISCOUNT RATE" ON ADVANCES TO MEMBER BANKS UNDER SECTIONS 13 AND 13A OF THE  
 FEDERAL RESERVE ACT IN EFFECT AT THE FEDERAL RESERVE BANK OF SAN FRANCISCO

March 12, 1990

The following is a list of rates of interest on our advances to, and discounts for, member banks and other depository institutions under Sections 13 and 13a of the Federal Reserve Act. Each rate (also referred to as the "discount rate") was in effect until the next date indicated.

| Effective Date |           |    | Rate<br>(% per annum) | Effective Date |           |    | Rate<br>(% per annum) |
|----------------|-----------|----|-----------------------|----------------|-----------|----|-----------------------|
|                |           |    | Days                  |                |           |    | Days                  |
| 1976           | January   | 19 | 5-1/2                 | 1981           | May       | 5  | 151 14                |
|                | November  | 22 | 5-1/4                 |                | November  | 2  | 181 13                |
| 1977           | September | 2  | 5-3/4                 |                | December  | 4  | 32 12                 |
|                | October   | 26 | 6                     | 1982           | July      | 20 | 228 11-1/2            |
| 1978           | January   | 13 | 6-1/2                 |                | August    | 2  | 13 11                 |
|                | May       | 11 | 7                     |                | August    | 16 | 14 10-1/2             |
|                | July      | 3  | 7-1/4                 |                | August    | 27 | 11 10                 |
|                | August    | 21 | 7-3/4                 |                | October   | 11 | 45 9-1/2              |
|                | September | 22 | 8                     |                | November  | 22 | 42 9                  |
|                | October   | 16 | 8-1/2                 |                | December  | 14 | 22 8-1/2              |
|                | November  | 2  | 9-1/2                 | 1984           | April     | 13 | <del>20</del> 185 9   |
| 1979           | July      | 20 | 10                    |                | November  | 21 | 222 8-1/2             |
|                | August    | 20 | 10-1/2                |                | December  | 24 | 33 8                  |
|                | September | 19 | 11                    | 1985           | May       | 21 | 148 7-1/2             |
|                | October   | 8  | 12                    | 1986           | March     | 7  | 283 7                 |
| 1980           | February  | 15 | 46 13                 |                | April     | 21 | 45 6-1/2              |
|                | May       | 29 | 103 12                |                | July      | 11 | 81 6                  |
|                | June      | 13 | 15 11                 |                | August    | 21 | 41 5-1/2              |
|                | July      | 28 | 45 10                 | 1987           | September | 9  | 384 6                 |
|                | September | 26 | 60 11                 | 1988           | August    | 9  | 334 6-1/2             |
|                | November  | 17 | 52 12                 | 1989           | February  | 24 | 199 7*                |
|                | December  | 5  | 18 13                 |                |           |    | 310 to 1-1-90         |
|                |           |    | 25 to 1-1-91          |                |           |    |                       |

From March, 1980 through November, 1981, surcharges were applied at various times on advances to certain depository institutions. The Federal Reserve Bank expresses no opinion on the applicability of the basic discount rate or surcharge to any transaction governed by a Federal or state usury or usury pre-emption statute.

\*current rate

Note: Number of days at each rate is handwritten on this chart  
 Hmc

ANATOMY OF A SETTLEMENT

Prepared by Department of Revenue

Oil and Gas Audit Division

March 2, 1990

## ANATOMY OF A SETTLEMENT

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## EXECUTIVE SUMMARY

### A. Synopsis

This report:

- o Reviews the authority and responsibility of the Department of Revenue
- o Briefly describes the ARCO settlement of October 1988
- o Describes the process from initial audit through the final settlement
- o Lists the participants and their qualifications

### B. Summary

The quality of a final settlement of a tax dispute is dependent upon a large number of factors from the initial audit through the appeals process and the final negotiations. The process provided in the statutes and regulations has been developed over a number of years. The staff of the Oil and Gas Audit Division is highly qualified and trained to conduct the complex audits of multi-national corporations and carry out the review and appeals process in the best interest of the State while at the same time protecting the rights of the taxpayers. The Division has also contracted with a world recognized firm in negotiating techniques to train the employees of the Departments of Revenue and Law so they are proficient in negotiating fair settlements.

It takes years of experience to develop an understanding of the books and records of a large corporation and the complex tax laws to make an informed judgment . This makes legislative oversight very difficult. However, the Legislature already has a competent staff in Legislative Audit who can review and judge the results of the settlement process. Public accountability can be maintained and enforced in this manner without placing barriers in the process that will further delay settlements.

## I. INTRODUCTION

Over the past few years the public and public officials have begun to believe the resolution process for settlement of outstanding tax disputes has broken down causing loss of revenue owed the State of Alaska. They fear that settlements may be based upon political or personal motives.

The Oil and Gas producers in Alaska are very large, multi-national corporations, thus making the audit process very long and complex. The Alaska tax laws are complicated and difficult to administer requiring special training and experience. In addition, the very large assessments cause concern to everyone. The quality of a final settlement agreement is determined by the qualifications of everyone involved and the effort put into the process from the initial audit through the appeals stages and negotiation of the agreement.

Disclosure laws providing confidentiality of taxpayer information adds to the public's concern over settlements. The public and public officials believe they cannot assess the results from the Department of Revenue and Department of Law without access to confidential information.

We believe a clearer understanding of the settlement process and the qualifications of the large number of participants may ease some of the fears expressed above.

## II. AUTHORITY, RESPONSIBILITY AND DUTIES OF THE DEPARTMENT OF REVENUE

The Commissioner of Revenue is assigned responsibility for the enforcement and collection of all taxes listed in Alaska Statute Section 43 and the audit of all reports and payments due relating to royalties and net profits under Section 38. A specific list of duties can be found at AS 43.05.010. (see copy - Appendix A (4))

In addition, there are other areas of responsibility which the statute addresses:

- o Inspection of records on premises and issuance of summons. AS 43.05.040 (See copy - Appendix A (5))
- o Taxpayer remedies. AS 43.05.240 (See copy - Appendix A (9))
- o Agreements with department respecting liability. AS 43.05.060 (See copy - Appendix A (6))
- o Compromise of tax or penalty. AS 43.05.070 (See copy - Appendix A (7))

### A. Audit

The Department of Revenue has authority (AS 43.05.040) to examine all books and records of a taxpayer and if necessary can issue a summons to enforce their requests. At the conclusion of the examination a report will be issued. The report will result in one of three possibilities, either an increase to the tax liability, a decrease to the tax liability or acceptance of the tax liability without change.

## B. Appeals

The statute (AS 43.05.240) provides a means of appealing the audit findings. A taxpayer who disagrees with an action of the Department is provided an appeal process which includes first an appeal for an informal conference and second an appeal for a formal hearing. Both the conference officer and hearing officer will hear the arguments and listen to the evidence provided by both the Department and the taxpayer and will issue a written decision. The decision will result in either an increase or decrease to the audit findings or acceptance without change.

## C. Agreements

The Statute (AS 43.05.060) authorizes the Department of Revenue to enter into agreements with taxpayers. There are two types of agreements, one entered into by the Department only and the other by both the Department of Revenue and Department of Law. When an agreement is signed by both the Department of Revenue and Department of Law it is "final and conclusive" and may not be reopened as to matters agreed upon (unless there is a showing of fraud, malfeasance, or a misrepresentation of a material fact); however, when only the Department of Revenue signs it is not final and conclusive and may be reopened with a showing of substantial change in the facts.

## D. Compromise

AS 43.05.070 gives the Department of Revenue authority to compromise a tax if there is doubt as to the liability or the collectibility of a tax. This authority is shared with the Department of Law and must have the Attorney General's approval.

### III. SETTLEMENT

ARCO Alaska, Inc.  
Separate Accounting Income Tax  
A.S. 43.21  
Agreement - October 1988 for Years 1978 Thru 1981

We will analyze this settlement because all of the participants are still involved in the process to settle other cases and have contributed to this report. Following the narrative portion of this report is Appendix B which lists all of the participants and their qualifications. As you read through the report you can refer to the Appendix to give you an understanding as to why these individuals were included in the process.

### IV. ARCO AUDIT ASSESSMENTS - INCOME TAX 43.21

#### A. 1978 Assessment dated August 31, 1981

Arne Bue, Senior Auditor, was assigned the audit of ARCO separate accounting income tax for 1978 in January 1980. As lead auditor he supervised Jeff Johnson, Stacey Scott, Wabe Kissick, Marty Bassett, and Sue Stauffer in conducting the audit. The audit report was completed on August 31, 1981.

#### B. 1979-1980-1981 Assessment dated Apr 18, 1986

On August 16, 1985 the Alaska Supreme Court upheld the separate accounting income tax A.S. 43.21. Instructions were given Arne Bue and his team to proceed with issuing the assessment of the years 1979 through 1981. This was completed on April 18, 1986. The law firm of Preston Thorgrimson was contracted to assist in this task. John Messenger, former Deputy Commissioner of Revenue and Joe Donohue, also

a former Deputy Commissioner of Revenue, both attorneys, worked closely with the Department in completing the assessment. Dr. Ernest Nadel, Economist and noted authority in Marine Transportation was also contracted to assist.

C. Briefing on Amerada Hess Litigation

In July of 1987 the new Division of Oil and Gas Audit of the Department of Revenue was formed. William Floerchinger, CPA with 25 years of experience in tax administration with the IRS, was hired as Director of the Division. The Division immediately undertook a complete review of the Oil and Gas issues and Department policies relating to these issues.

The Director and members of the Division attended a week long briefing of the Amerada Hess royalty litigation in late July 1987. The briefing was conducted by the litigation team lead by Wilson Condon, Attorney and former Attorney General.

D. Review of Issues and Policies

In mid-August 1987 the Department held a week long seminar where we discussed the major oil and gas issues. Three economists with world wide experience and current knowledge about the ANS market were contracted to assist in the review.

They were: Dr. John Gault, Geneva, Switzerland; Dr. Arlan Tussing, Seattle, Washington; and Dr. Michael Tonzer of New York, New York. Immediately following this seminar, joint meetings were held between Oil and Gas Audit Division and Attorneys from the Department of Law to review and update the State position on all of the major tax

issues confronting the Department. These meetings continued well into 1988. During this review we continued to consult Dr. Gault, Dr. Nadel, and Dr. Jeff Leitzinger who was on contract with the Amerada Hess royalty litigation. In addition, we began consulting with Dr. Tom Horst from Washington, D.C. on the TAPS debt allocation issue and Spencer Hosie, Attorney from San Francisco on the entitlements issue.

E. Amended Assessment - November 16, 1987

An amended assessment was prepared to incorporate the new information and policy changes developed during the review.

F. Amended Assessment - December 18, 1987

Additional assessments were made to add the entitlements issue to the case. This also was done as a result of our review of the issues in the month's prior to December.

V. PREPARATION FOR FORMAL HEARING

A. Initial Strategy For Formal Hearing

The first pre-hearing conference at the formal hearing level on this case was held in January 1987. This was the largest case that had ever reached the formal hearing process, in amount of taxes in dispute, the number of issues in dispute, and the complexity of the case. This is demonstrated by the fact that when the parties entered into a Scheduling Conference Stipulation and Order in February 1987 a

hearing was scheduled for June 1988 which was anticipated to last four weeks. This was 18 months from the start of the proceedings.

The case was being prepared by the Oil, Gas, and Mining Section of the Department of Law in coordination with the Oil and Gas Audit Division. The Department of Law hired outside counsel and experts to assist them in the preparation of the case. The case was divided into three issue teams: Valuation, Transportation, and Pipeline.

The primary members of each team was as follows:

| <u>Valuation</u> | <u>Transportation</u> | <u>Pipeline</u>  |
|------------------|-----------------------|------------------|
| Ronald Bitzer    | Ronald Bitzer         | Ronald Bitzer    |
| Arne Bue         | Arne Bue              | Maureen O'Brien  |
| Ernie Nadel      | Ernie Nadel           | Ernie Nadel      |
| Maureen O'Brien  | Maureen O'Brien       | Michael Hotchkin |
| Barbara Herman   | Robert Loeffler       | Robert Loeffler  |
| Shelley Higgins  |                       | Tom Horst        |
| Joseph Donohue   |                       |                  |
| Spencer Hosie    |                       |                  |
| Jeff Leitzinger  |                       |                  |

There were numerous additional attorneys and economists who supported the above people.

As part of the Scheduling Conference Stipulation, the Division was allowed to make an additional assessment correcting and adding additional issues. This project was completed in two parts in November and December 1987.

At the same time a tremendous amount of discovery was being conducted. The requests included production of documents, interrogatories, depositions, witness lists, obtaining experts, and working on pre-filed testimony. During this time period many motions on procedure and motions for partial summary judgment on the issues were filed.

## B. Amended Strategy For Resolution of Case

By January 1988 extensive preparation for the upcoming hearing had taken place. Hundreds of thousands of documents had been accumulated, categorized, and summarized. However, it became clear that as a result of the preparation for the case, a single hearing of 4 weeks would not be sufficient. The case was divided, and a second hearing added, which ultimately took place in December 1988. It also became quite clear, that the amount of the preparation had allowed both sides to focus on the individual issues involved and that both sides now had a better understanding of both the strengths and weaknesses of their respective positions. However, the parties had not directly talked about the individual issues with each other.

## VI. RESOLUTION TEAM - INFORMAL DISCUSSION

In late January 1988, the Division and the Taxpayer agreed to the ground rules which established what has been known as the Resolution Team. The Resolution Team consisted of Arno Bue, the lead auditor on the case, Bruce Kinney, the Audit Supervisor over the case, Richard Brewer, Assistant to the Director, who represented the Director, and Ronald Bitzer, Senior Appeals Officer, who was in charge of the case. We started discussing the issues one by one. Due to the extensive case preparation that was occurring, the availability of experts, and the willingness of the Taxpayer to provide additional information that was

needed, we were able to resolve various issues. As a result of these agreements, all of the issues that were set for the first hearing scheduled for June 1988 were resolved. These agreements were not only reviewed and approved by the Resolution Team involved, they were approved by the Director of the Oil & Gas Audit Division. They were then reviewed and approved by the Department of Law and outside counsel that had been retained.

## VII. SETTLEMENT - OCTOBER 1988

### A. Proposal From Taxpayer

The Resolution Team continued to work throughout the summer months reviewing various issues. In August 1988, the Taxpayer made a global offer to the Department of Revenue to resolve the entire case. At that time the Department of Law working with the outside counsel and experts, and the Oil & Gas Audit Division prepared an evaluation of the case, issue by issue. This evaluation incorporated all of the previous agreements that had been reached, and evaluated our position on the remaining issues.

Our evaluation included hazards of litigation, costs of litigation and potential settlement results. We also determined that at least two and possibly three issues would not be on the negotiating table because of the impact upon all the other taxpayer producers in Alaska. A strong need existed for obtaining court precedent in these areas.

In response to the taxpayer's request we set up the following teams for negotiating a potential settlement.

B. Negotiating Team

|                   |                                     |
|-------------------|-------------------------------------|
| Bill Floerchinger | Director, Oil & Gas Audit Division  |
| Dick Brewer       | Assistant Director, Oil & Gas Audit |
| Ronald Bitzer     | Senior Appeals Officer              |
| Bruce Kinney      | Supervisor, Oil & Gas Audit         |
| Arne Bue          | Senior Revenue Auditor              |
| Ron Lorenson      | Deputy Attorney General             |

This team sat at the negotiating table and hammered out the provisions of the agreement.

C. Support Team

|                |                            |
|----------------|----------------------------|
| Barbara Herman | Assistant Attorney General |
| Craig Tillery  | Assistant Attorney General |
| Mike Hotchkin  | Assistant Attorney General |
| John Messenger | Preston, Thorgrimson       |
| Joe Donohue    | Preston, Thorgrimson       |

This team was available in a room next door and caucused with the negotiating team at each break in the session.

D. Outside Support

|                 |                                     |
|-----------------|-------------------------------------|
| Spencer Hosie   | Attorney, San Francisco, California |
| Robert Loeffler | Attorney, Washington, D.C.          |
| Ernie Nadel     | Economist, Oakland, California      |
| Jeff Leitzinger | Economist, Los Angeles, California  |

This team was constantly available to discuss the issues by telephone and recommend conditions for this settlement agreement.

E. Briefings

Throughout the time after the resolution team was established the Commissioner was briefed regularly. During the final days of

negotiating the Commissioner was briefed at least once a day and sometimes more often. Early on, the Governor was made aware of the negotiations and was fully briefed in Anchorage within one week prior to the agreement. Mary Halloran, Director, Division of Policy and Richard Fineberg, Analyst for the Division of Policy were briefed during the last days of the negotiations.

F. Approvals

The final written agreement was approved by the following individuals for the State of Alaska:

|                     |                                    |
|---------------------|------------------------------------|
| Hugh Malone         | Commissioner of Revenue            |
| Bill Floerchinger   | Director, Oil & Gas Audit Division |
| Grace Berg Schaible | Attorney General                   |

As a result of the resolution process, a very complicated case was ultimately reduced to two issues that went forward to hearing. Without such a process, a formal hearing would have been a most difficult, costly and time consuming affair.

VIII. CONFIDENTIALITY

A. Responsibility of the Department of Revenue

Tax administration explicitly covers not only return processing and monitoring but also entails audits of the taxpayer's books and records to assure compliance with related statutes and regulations.

The ability of the Department of Revenue to conduct audits of taxpayer and royalty filings is founded in AS 43.05.040 and AS 38.05.180:

(a) The department may examine the books, papers, records, or memoranda of any person to ascertain the correctness of a return filed or to determine whether a tax or a payment for oil or gas royalty is due. The records and the premises where a business is conducted shall be open at all reasonable times for official inspection, and the department may summon any person to appear and produce books, records, papers, or memoranda bearing upon tax matters or matters relating to oil and gas royalty or net profits . . .

AS 43.05.040 also deals with the summons authority of the Department of Revenue:

(b) A summons may be served by the commissioner of public safety or peace officer designated by the commissioner or by a person designated by the Department of Revenue. . .

For the audits of royalties and net profit payments, the statutes under AS 38.05.036 enumerate:

(a) The Department of Revenue shall audit reports, payments, and payments due relating to royalty and net profits under oil and gas contracts, agreements, or leases under this chapter.

(b) The Department of Revenue may inspect all reports and other information filed in support of or relating to royalty and net profits payments, whether or not that information is confidential, and shall hold that information confidential to the extent required under oil and gas agreements, contracts, or leases, or by this chapter or AS 43.05.230.

#### B. Linchpin of Tax Administration

Confidentiality is the linchpin to administration of Alaska's tax and royalty statutes and regulations. AS 09.25.100 states that:

Information in the possession of the Department of Revenue which discloses the particulars of the business or affairs of a taxpayer or other person is not a matter of public record, except for purposes of investigation and law enforcement. The information shall be kept confidential except when its production is required in an official investigation or court proceeding.

Further, AS 43.05. 230(a) also provides in pertinent part:

(a) It is unlawful for a current or former officer, employee, or agent of the state to divulge the amount of income or the particulars set out or disclosed in a report or return made under AS 43.05.010-43.80.040, except (1) in connection with official investigations or proceedings of the department, whether judicial or administrative, involving taxes due under this title.

The foregoing provisions of Alaska's statutes provide assurance to taxpayers that information pertaining to tax administration will be kept confidential under applicable statutes and regulations. This assurance to taxpayers is also founded in the summons power of the Department. The information subject to a summons request must have relevance to the administration of Alaska's taxing statutes and regulations. Further, the assurance of confidentiality that is afforded the summoned information serves to dispel any defense from the taxpayer about compliance with the summons request.

So why is confidentiality crucial to tax administration?

Because absent this assurance, taxpayers will be disinclined to provide information at the Department's request that corroborates information in tax and royalty filings. It is that simple.

Further, Departmental employees are charged with a heavy burden of assuring this confidentiality, the consequences of which are substantial fines and penalties:

(f) A willful violation of the provisions of this section is punishable by a fine of not more than \$5,000, or by imprisonment for not more than two years, or by both.  
(AS 43.05.230)

C. Nature of the Information Produced During an Audit

Much of the information disclosed to the Department during the course of audits is highly confidential and sensitive. Trade secrets, marketing strategies, and pricing philosophies may be contained in the information requested and disclosed during the course of an audit. Should this information fall into competitor's hands, unfair advantages may result with irreparable harm occurring to the disclosing taxpayer. The confidentiality statutes serve to obviate this concern and place a heavy burden on the Department in maintaining the confidentiality of taxpayer information.

In this regard, during the course of an audit, information gathered from one producer often is used in assessments of other producers. The market for ANS is very focused and sales, exchanges, dispositions, and netback values realized by one producer may form the benchmark for assessments of value against another producer. So that specific information from one taxpayer may be disclosed to another taxpayer, a regulation has been enacted:

15 AAC 05.250. USE OF CONFIDENTIAL INFORMATION IN ENFORCEMENT PROCEEDING. (a) Department representatives will, in their discretion disclose confidential information obtained from a taxpayer in an audit or investigation of another taxpayer . . . The information will be disclosed only to parties, counsel, experts, and consultants involved in the proceeding after notification to the taxpayer whose information is to be disclosed. The information will be disclosed only under an administrative protective order and only after the taxpayer whose information is to be disclosed has had an opportunity to appear and present objections to that representative.

Obviously, confidentiality serves to form the underpinnings for the entire audit process.

D. Summary

The confidentiality statutes allow access to complex and sensitive information. Taxpayers are inclined to make available the information requested by auditors through the normal audit process or as a result of the summons power only because of the confidentiality afforded by statute and regulation. The ready submission of confidential records allows the Department to adequately administer the tax statutes. Absent confidentiality, the process will be destroyed and effective administration will become the purview of the judicial system.

**Sec. 09.25.090. Objections to tender:** The person to whom a tender is made shall at the time specify any objection the person may have to the money, instrument, or property, or the person waives it. If the objection is to the amount of money, the terms of the instrument, or the amount or kind of property, the person shall specify the amount, terms, or kind which the person requires, or is precluded from objecting later. This section shall not be construed to modify or change in any manner corresponding provisions of the Uniform Commercial Code (AS 45.01 — 45.09). (§ 3.20 ch 101 SLA 1962)

#### NOTES TO DECISIONS

It is not necessary to tender cash. constitute a proper tender. Ward v. Ward v. Miller, 13 Alaska 752 (1952). Miller, 13 Alaska 752 (1952).  
And a check, unobjected to, would

**Sec. 09.25.100. Disposition of tax information.** Information in the possession of the Department of Revenue which discloses the particulars of the business or affairs of a taxpayer or other person is not a matter of public record, except for purposes of investigation and law enforcement. The information shall be kept confidential except when its production is required in an official investigation or court proceeding. These restrictions do not prohibit the publication of statistics presented in a manner that prevents the identification of particular reports and items, or prohibit the publication of tax lists showing the names of taxpayers who are delinquent and relevant information which may assist in the collection of delinquent taxes. (§ 3.21 ch 101 SLA 1962)

**Collateral references.** — Validity, construction, and effect of state laws requiring state officials to protect confidentiality of income tax returns and information, 1 ALR4th 959.

**Sec. 09.25.110. Inspection and copies of public records.** Unless specifically provided otherwise the books, records, papers, files, accounts, writings, and transactions of all agencies and departments are public records and are open to inspection by the public under reasonable rules during regular office hours. The public officer having the custody of public records shall give on request and payment of costs a certified copy of the public record. (§ 3.22 ch 101 SLA 1962)

**Cross references.** For proof of public records, see Evid. R. 1005; for management and preservation of public records, see AS 40.21.

his claim was defined as a parcel of similar utility to the homestead in 1959, and he was not entitled to land on a value-for-value basis merely because the homestead land was presently worth two or three million dollars. *Messerli v. Department of Natural Resources*, 768 P.2d 1122 (Alaska 1989).

The leasing of state lands is governed by regulations promulgated by the commissioner of the Department of Natural Resources, pursuant to AS 38.05.020(b)(1), and executed by the Director of the Division of Lands, pursuant to paragraph (a)(3) of this section. *Swindel v. Kelly*, 499 P.2d 291 (Alaska 1972).

**Construction of state lease provision reserving right to grant right-of-way.** — Provision in a lease issued by the State of Alaska, Division of Lands, expressly reserving the right to grant an easement or right-of-way across the leased property was construed to include an interagency transfer of a right-of-way to the Department of Transportation and Public Facili-

ties. *Wessells v. State, Dep't of Hwys.*, 562 P.2d 1042 (Alaska 1977).

**Contract for sale without commissioner's approval.** — The director can only approve and issue a contract for sale without the commissioner's approval if the appraised value of the land is less than \$50,000. *Messerli v. Department of Natural Resources*, 768 P.2d 1122 (Alaska 1989).

**Applied in** *Hammond v. North Slope Borough*, 645 P.2d 750 (Alaska 1982); *Hoblitt v. Commissioner of Natural Resources*, 678 P.2d 1337 (Alaska 1984).

**Quoted in** *Alyeska Ski Corp. v. Holdsworth*, 426 P.2d 1006 (Alaska 1967); *Alaska Survival v. State, Dep't of Natural Resources*, 723 P.2d 1281 (Alaska 1986); *Aspen Exploration Corp. v. Sheffield*, 739 P.2d 150 (Alaska 1987).

**Cited in** *State v. Bering Strait Regional Educ. Attendance Area School Dist.*, 658 P.2d 784 (Alaska 1983); *Chevron U.S.A., Inc. v. LeResche*, 663 P.2d 923 (Alaska 1983).

### Sec. 38.05.036. Audit of royalty and net profit payments.

(a) The Department of Revenue shall audit reports, payments, and payments due relating to royalty and net profits under oil and gas contracts, agreements, or leases under this chapter.

(b) The Department of Revenue may inspect all reports and other information filed in support of or relating to royalty and net profits payments, whether or not that information is confidential, and shall hold that information confidential to the extent required under oil and gas agreements, contracts, or leases, or by this chapter or AS 43.05.230.

(c) All information obtained by the Department of Revenue relating to royalty and net profits payments, including information obtained under AS 43, may be made available to the department, in the form of summaries and, when in furtherance of the department's royalty and net profits functions, relevant portions of the audits. Information made available to the department that was obtained under AS 43 is confidential and subject to the provisions of AS 43.05.230.

(d) The Department of Revenue may conduct audits under this section concurrently with audits or investigations under AS 43, and may use information obtained from the department in tax audits, investigations, or proceedings under AS 43.

(e) In this section, "audit" means the process of obtaining sufficient competent evidentiary matter through inspection, observation, inquiry, and confirmation to afford a reasonable basis for ascertaining the compliance by the subject of the audit with the applicable law, regulation, lease, agreement, and contract terms; it does not include

any other actions necessary to administer this chapter pertaining to oil and gas royalty and net profits payments, including daily accounting functions, certification procedures associated with those accounting functions, and enforcement of payments of royalties and net profits. (§ 2 ch 61 SLA 1980)

**Sec. 38.05.037. Zoning regulations in the unorganized borough.** (a) In areas of the state outside first, second or third class boroughs where there is no municipality with a zoning power, the division of lands shall exercise the zoning power by adopting zoning regulations.

(b) The division of lands may exercise its zoning power

(1) within federal land in the unorganized borough only at the times and in the areas it is requested to do so by the Secretary of the Interior to facilitate sales of federal land within the unorganized borough under P.L. 88-608, 78 Stat. 988;

(2) within any portion of a third class borough covered by the Alaska coastal management program adopted in accordance with the provisions of AS 46.40 if the municipality has not done so.

(c) Any zoning done by the division of lands under (b) of this section is final unless disapproved by concurrent resolution at the next regular session of the legislature. (§ 6 ch 118 SLA 1972; am § 5 ch 93 SLA 1977; am § 14 ch 138 SLA 1977)

**Opinions of attorney general.** — The zoning power vested in the Department of Natural Resources under this section is broad enough to encompass the creation of historical districts as a control over land use, but the exercise of that authority

does not make the property eligible for historic preservation loans under AS 45.98, which is aimed solely at historic districts established by municipalities. January 3, 1980, Op. Att'y Gen.

**Sec. 38.05.040. Director shall be bonded.** Before performing any duties, the director shall execute a corporate surety bond to the state in the sum of \$150,000, conditioned upon the faithful performance of all duties under this chapter and upon the prompt and faithful accounting of all money collected by the director or deputies, assistants, employees or agents of the director. The bond, together with additional conditions or limitations considered necessary, shall be approved by the attorney general and filed in the office of the governor. The premium upon the bond is payable from money appropriated for operation of the division. (§ 6 art II ch 169 SLA 1959)

**Sec. 43.05.010. Duties of commissioner of revenue.** The commissioner of revenue shall

(1) exercise general supervision and direct the activities of the Department of Revenue;

(2) supervise the fiscal affairs and responsibilities of the department;

(3) prescribe uniform rules for investigations and hearings;

(4) keep a record of all departmental proceedings, record and file all bonds and assume custody of returns, reports, papers and documents of the department;

(5) make recommendations and an annual report to the governor to be transmitted to the legislature concerning the condition, operation and functioning of the department and state laws relating to taxation and tax administration;

(6) adopt a seal and affix it to each order, process, or certificate issued by the commissioner;

(7) keep a record of each order, process, and certificate issued by the commissioner, and keep the record open to public inspection at all reasonable times;

(8) hold hearings and investigations necessary for the administration of state tax and revenue laws;

(9) hear and determine appeals involving income, excise, license, or other taxes levied under state laws and enter orders on the appeals which are final unless reversed or modified by the courts;

(10) require the attendance of witnesses and the production of necessary books, papers, documents, correspondence and other evidence at hearings;

(11) order the taking of depositions before a person competent to administer oaths;

(12) administer oaths and take acknowledgments;

(13) request the attorney general for rulings on the interpretation of the tax and revenue laws administered by the department;

(14) call upon the attorney general to institute actions for recovery of unpaid taxes, fees, excises, additions to tax, penalties and interest;

(15) issue warrants for the collection of unpaid tax penalties and interest and take all steps necessary and proper to enforce full and complete compliance with the tax, license, excise, and other revenue laws of the state;

(16) audit reports, payments, and payments due relating to royalty and net profits under oil and gas contracts, agreements, or leases under AS 38.05. (§ 48-2-9 ACLA 1949; § 7-1-8 ACLA 1949; am § 3 ch 61 SLA 1980)

**Effect of amendments.** — The 1980 amendment added paragraph (16).

## NOTES TO DECISIONS

Department of Revenue's failure to affix the seal of the commissioner of revenue to a summons issued under AS 43.05.040 was harmless error. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156-1157 (1981). Cited in Wien Air Alaska, Inc. v. Department of Revenue, Sup. Ct. Op. No. 2527 (File No. 5594), P.2d (1982).

**Sec. 43.05.020. Collection agencies.** The commissioner of revenue may employ a collection agency outside the state to assist in the collection of revenue owed to the state. The commissioner may pay for these services by entering into contingent fee agreements the commissioner considers reasonable, or by the payment of amounts out of the proper appropriation for the department the commissioner considers reasonable. (§ 48-2-9(y) 1949; § 1 ch 100 SLA 1960)

**Sec. 43.05.025. Audit agents.** The commissioner of revenue may employ agents outside the state to assist in the audit of books and records located outside the state. Agents employed under this section are subject to the restrictions of AS 43.05.230. (§ 1 ch 166 SLA 1976)

**Sec. 43.05.030. Branch offices.** The department may establish branch offices essential for the efficient administration of its duties. (§ 48-2-8 ACLA 1949)

**Sec. 43.05.040. Inspection of records or premises and issuance of summons.** (a) The department may examine the books, papers, records, or memoranda of any person to ascertain the correctness of a return filed or to determine whether a tax or a payment for oil or gas royalty or net profits shares under a contract, agreement, or lease under AS 38.05 is due, or in an investigation or inspection in connection with tax matters or matters relating to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05. The records and the premises where a business is conducted shall be open at all reasonable times for official inspection, and the department may summon any person to appear and produce books, records, papers, or memoranda bearing upon tax matters or matters relating to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05, and to give testimony or answer interrogatories under oath respecting tax matters or matters related to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05, and the department may administer oaths to persons who are so summoned.

(b) A summons may be served by the commissioner of public safety or a peace officer designated by the commissioner or by a person designated by the Department of Revenue. If a person who is summoned neglects or refuses to obey the summons issued as provided in this section, the department may report the fact to the superior court and the court may compel obedience to the summons to the same extent as witnesses may be compelled to obey the subpoenas of the court. (§ 48-2-12(a) (b) ACLA 1949; am § 4 ch 61 SLA 1980)

**Effect of amendments.** — The 1980 amendment in subsection (a); inserted "or a payment for oil or gas royalty or net profits shares under a contract, agreement, or lease under AS 38.05" in the

first sentence, and inserted "or matters related to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05" in three places in that subsection.

## NOTES TO DECISIONS

**For a discussion of the proper scope of summons issued by the Department of Revenue under this section, see State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049); 636 P.2d 1156 (1981).**

**Constitutionality of summons.** — Department of Revenue's summons which was reasonably specific, asked only for material relevant to a legitimate tax inquiry, and was enforceable only by court order did not violate taxpayer's right

against unreasonable searches and seizures. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981).

**Harmless error.** — Department of Revenue's failure to affix the seal of the commissioner of revenue to a summons issued under this section was harmless error. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981).

**Sec. 43.05.050. Return by department upon failure to make return or making false or fraudulent return.** If a person fails to file a return at the time prescribed by law or by regulation, or makes, wilfully or otherwise; a false or fraudulent return, the department shall make the return from the information it obtains. A return made by the department is prima facie good and sufficient for all legal purposes. (§ 48-2-13 ACLA 1949)

## NOTES TO DECISIONS

**Application of privilege against self-incrimination.** — The privilege against self-incrimination does not extend to the right to refuse to file a tax return. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981); Cogan v. State, Dep't of Revenue, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

A blanket refusal to disclose any financial information on a tax return based on the privilege against self-incrimination is equivalent to filing no return at all. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981); Cogan v. State, Dep't of Revenue, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

The privilege against self-incrimination

may be validly claimed in a prosecution for failure to file to avoid answering particular questions on a tax return if the answers to those questions would tend to incriminate an individual. State, Dep't of Revenue v. Oliver, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981).

**Computation of tax based on W-2 forms.** — An individual's privacy rights were not violated by the state's computation of tax liability based on W-2 forms after that person failed to file a tax return because the state did not ask the person anything but rather simply imposed a tax based on available information. Cogan v. State, Dep't of Revenue, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

**Sec. 43.05.060. Agreements with department respecting liability.** The department may enter into an agreement with a person relating to the liability of the person, or of a person or estate the person

represents, for a tax, license fee, or excise tax for a period ending before the date of the agreement. If the agreement is approved by the attorney general, the agreement is final and conclusive and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact, the case may not be reopened as to the matters agreed upon or the agreement modified. In a suit or proceeding relating to the tax liability of the taxpayer the agreement may not be annulled, modified, set aside, or disregarded. (§ 48-2-14 ACLA 1949)

#### NOTES TO DECISIONS

Quoted in *Wien Air Alaska, Inc. v. Department of Revenue*, 2527 (File No. 5594), P.2d (1982).  
Sup. Ct. Op. No.

**Sec. 43.05.070. Compromise of tax or penalty.** (a) If in the opinion of the department there is doubt as to the liability of the taxpayer for or the collectibility of a tax, license fee, or excise tax, the department, with the approval of the attorney general, may compromise the tax.

(b) The department, with the approval of the attorney general, may, for cause shown, compromise a penalty accruing under the state tax, license, or excise tax laws. (§ 48-2-15(a) (c) ACLA 1949)

**Sec. 43.05.080. Adoption of regulations.** The department shall adopt and publish regulations necessary for the enforcement of the tax, license, or excise tax laws administered by it. The department shall prepare and distribute all forms necessary or useful in the administration of tax, license, and excise tax laws. (§ 48-2-16 ACLA 1949)

#### NOTES TO DECISIONS

Cited in *Wien Air Alaska, Inc. v. Department of Revenue*, 2527 (File No. 5594), P.2d (1982).  
Sup. Ct. Op. No.

**Sec. 43.05.085. List of contributors.** The commissioner of revenue shall prepare and furnish to the Alaska Election Campaign Commission by July 1 of each year a list of all persons claiming a credit under AS 43.20.010(c), including the dates, if available, and candidates or groups to which the contribution was made. These lists or parts of them shall not be made public except on order of the supreme court of the state. (§ 4 ch 76 SLA 1974)

**Editor's notes.** — AS 43.20.010(c) was repealed in 1975. The present provisions for tax credits for political contributions are found in AS 43.20.013.

(e) A penalty imposed by this section shall be collected at the same time, in the same manner, and as a part of the original tax. However, if the original tax is paid before neglect or fraud is discovered, the penalty shall be collected in the same manner as the original tax. Interest may not be collected on a penalty imposed by this section. (§ 2 ch 166 SLA 1976; am § 1 ch 113 SLA 1980; am § 1 ch 39 SLA 1982)

**Effect of amendments.** — The 1980 amendment, in subsection (a), inserted "at the time or times required by law or regulation" in the first sentence and deleted the former third sentence, which read: "The penalty shall be collected at the same time, in the same manner and as a part of

the original tax; but if the original tax is paid before the neglect is discovered, the penalty shall be collected in the same manner as the original tax", and added subsections (b)-(e).

The 1982 amendment, added the present third sentence of subsection (a).

**Sec. 43.05.225. Interest on taxes.** Unless otherwise provided, when a tax levied in this title becomes delinquent it bears interest at the rate of 12 percent a year. (§ 2 ch 166 SLA 1976; am § 2 ch 82 SLA 1982)

**Effect of amendments.** — The 1982 amendment increased the rate of interest from eight percent to 12 percent.

**Sec. 43.05.230. Disclosure of tax returns and reports.** (a) It is unlawful for a current or former officer, employee, or agent of the state to divulge the amount of income or the particulars set out or disclosed in a report or return made under this title, except

(1) in connection with official investigations or proceedings of the department, whether judicial or administrative, involving taxes due under this title;

(2) in connection with official investigations or proceedings of the child support enforcement agency, whether judicial or administrative, involving child support obligations imposed or imposable under AS 25 or AS 47;

(3) as provided in AS 38.05.036 pertaining to audit functions; and

(4) as otherwise provided in this section.

(b) The department, upon written request, shall furnish to the taxpayer a copy of the taxpayer's tax return upon payment of a fee of \$1 per page.

(c) The department may permit the proper officer of the United States or of a state, territory or possession of the United States or of the Dominion of Canada or of a province or territory of Canada, or the officer's authorized representative, to inspect tax returns or reports filed with the department, or may furnish to the officer or representative a copy of the tax return, if the other jurisdiction grants substantially similar privileges to the department or its representative or to counsel for the state; and if the department determines that the

other jurisdiction provides adequate safeguards for the confidentiality of the returns and reports, and that the returns and reports will be used for tax purposes only. The department may also permit the employment security division of the Alaska Department of Labor to inspect tax returns or reports filed with the department or may furnish a copy of the tax returns for tax purposes only.

(d) The commissioner of revenue may furnish to the Multistate Tax Commission or other authorized agent information contained in the tax returns, reports, related schedules and documents filed under an audit or investigation of a multistate business made by the department. This information may be furnished for tax purposes only. The Multistate Tax Commission or other authorized agent may make the information available to the tax officials of other states, the District of Columbia, the United States and its territories for tax purposes only.

(e) Nothing in this section prohibits the publication of statistics so classified as to prevent the identification of particular returns or reports or the publication of delinquent lists showing the names of taxpayers who have failed to pay their taxes at the time and in the manner provided by law, together with other relevant information which in the opinion of the department may assist in the collection of delinquent taxes.

(f) A wilful violation of the provisions of this section is punishable by a fine of not more than \$5,000, or by imprisonment for not more than two years, or by both.

(g) The information contained in a license issued by the commissioner of revenue under AS 43.50, 43.60, 43.65, 43.70, and 43.75 is public information. (§ 2 ch 166 SLA 1976; am § 32 ch 126 SLA 1977; am § 5 ch 61 SLA 1980; am §§ 2, 3 ch 113 SLA 1980)

**Revisor's notes.** — The two 1980 amendments have been reconciled.

**Cross references.** — For purpose of 1977 amendatory act, see § 1, ch. 126, SLA 1977 in the Temporary and Special Acts.

**Effect of amendments.** — The first 1980 amendment rewrote subsection (a).

The second 1980 amendment substituted "a current or former" for "an" preceding "officer" near the middle of subsection (a) as it existed prior to the first 1980 amendment and added subsection (g).

**Opinions of attorney general.** — Division of audit to have access to records of state agencies, whether confidential or not. 1972 Op. Att'y Gen., issued under former AS 43.20.190.

A legislative auditor may not examine confidential records on file for state income tax returns and wage information submitted by employees and employers to the Department of Labor in connection with the administration of the State Employment Security Act to determine if persons receiving assistance from the Department of Health and Social Services under their Adult Public Assistance and Aid to families with dependent children were eligible. Such data is within the ambit of protection intended to be afforded the right of privacy under § 22, art. I, of the Alaska Constitution. 1972 Op. Att'y Gen., issued under former AS 43.20.190.

## NOTES TO DECISIONS

**Constitutionality.** — Given the lack of connection between most information sought on a tax return and a person's more intimate concerns and the confidentiality protections afforded by this section, the state's interest in the implementation of its tax system justifies and outweighs any privacy rights violated by compulsion to fill out tax forms or testify before a revenue agent. *State, Dep't of Revenue v. Oliver*, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981).

Subsection (c) provides adequate protection for an invasion of privacy rights that might occur as the result of the implementation of the state tax system.

*Cogan v. State, Dep't of Revenue*, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

An individual's privacy rights were not violated by the state's computation of tax liability based on W-2 forms after that person failed to file a tax return because the state did not ask the person anything but rather simply imposed a tax based on available information. *Cogan v. State, Dep't of Revenue*, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

Cited in *State, Dep't of Revenue v. Oliver*, Sup. Ct. Op. No. 2441 (File Nos. 4755, 5049), 636 P.2d 1156 (1981).

**Collateral references.** — Validity, construction, and effect of state laws requiring public officials to protect confi-

dentiality of income tax returns or information, 1 ALR4th 959.

**Sec. 43.05.240. Taxpayer remedies.** (a) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department within 60 days from the date of mailing the notice required to be given to the person by the department, giving notice of the grievance, and requesting an informal conference. At the conference the person aggrieved may present arguments and evidence relevant to the amount of tax or penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(b) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department and request a formal hearing

(1) in place of the informal conference provided for in (a) of this section, within 60 days from the date of mailing the notice required to be given to the person by the department; or

(2) within 30 days after decision resulting from an informal conference.

(c) At the formal hearing the department may subpoena witnesses and may administer oaths and make inquiries necessary to determine the amount of the tax or penalty due the state. The person aggrieved may present arguments and evidence relevant to the amount of the tax or penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(d) Within 30 days after the formal hearing and decision by the department, a person aggrieved by the decision of the department may appeal to the superior court in the judicial district in which the person

resides. The taxpayer shall be given access to the file of the department in the matter for preparation of the appeal. If after the appeal is heard it appears that the tax was correct, the court shall confirm the tax. If incorrect, the court shall determine the amount of the tax and if the person aggrieved is entitled to recover the tax or part of it, the court shall order the repayment and the department shall immediately pay the amount due and attach a certified copy of the judgment to the payment. (§ 2 ch 166 SLA 1976)

#### NOTES TO DECISIONS

**Means of challenging tax assessment.** — Under this section and App. R. 601-611, the exclusive means of challenging a tax assessment is by appeal to the superior court. *Fedpac Int'l, Inc. v. State*, Sup. Ct. Op. No. 2520 (File No. 6034), 646 P.2d 240 (1982).

**Collateral estoppel.** — If a later proceeding is concerned with a similar or unlike claim relating to a different tax year, a prior judgment acts as a collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit. *State v. Baker*, Sup. Ct. Op. No. 227 (File No. 428), 393 P.2d 893 (1964), decided

under former AS 43.70.050.

**Res judicata.** — If a claim of liability or nonliability relating to a particular tax year is litigated, a judgment on the merits is res judicata as to any subsequent proceeding involving the same claim and the same tax year. *State v. Baker*, Sup. Ct. Op. No. 227 (File No. 428), 393 P.2d 893 (1964), decided under former AS 43.70.050.

Cited in *Sjong v. State*, Dep't of Revenue, Sup. Ct. Op. No. 2269 (File No. 4255), 622 P.2d 967 (1981); *Cogan v. State*, Dep't of Revenue, Sup. Ct. Op. No. 2597 (File No. 6528), 657 P.2d 396 (1983).

**Sec. 43.05.245. Assessment and collection of tax, penalties and interest.** If a taxpayer fails to file a return or report required by this title in the time required by law or regulation, or makes an erroneous or fraudulent return, the department shall proceed to assess the license fees, tax, penalties, or interest and make a return from information which it obtains. A return made and subscribed by the department in accordance with this section is presumed sufficient for all legal purposes. However, nothing prevents a taxpayer from presenting evidence or other information on an appeal under AS 43.05.240 in order to rebut the presumed sufficiency of a return made and subscribed by the department, nor does the presumption of sufficiency alter the parties' respective burdens of proof once the taxpayer has presented evidence or other material information to rebut that presumption. The assessment of license fees, tax, penalties, or interest under this section occurs when the department issues a notice and demand for payment of the license fees, tax, penalties, or interest. The notice and demand for payment is issued when the notice and demand is delivered to the taxpayer in person or placed in the United States mail, addressed to the last known address of the taxpayer. Penalties and interest assessed under this title shall be collected in the same manner as provided in this title for the collection of tax or license fees. (§ 4 ch 113 SLA 1980)

APPENDIX B

Qualifications of Participants

- Bassett, Martin - Appeals Officer.  
CPA  
IRS - 5 1/2 years  
Oil and Gas Audit - 6 years  
Peat Marwick (CPA's) Auditor
- Bitzer, Ronald - Senior Appeals Officer.  
Attorney  
Controller - 5 years (Corporation in Private Industry)  
IRS - 1 year  
Department of Revenue - 6 years  
Oil and Gas Audit - 5 years
- Brewer, Richard - Asst Director, Oil and Gas Audit  
CPA  
Oil and Gas Audit - 6 years  
Department of Revenue - 10 years
- Bue, Arne - Senior Revenue Auditor  
20 years experience with Department of Revenue  
11 years experience in Oil and Gas Audit
- Condon, Wilson - Attorney  
Hellen, Partnow, and Condon  
Former Attorney General for Alaska
- Donohue, Joseph - Attorney  
Preston, Thorgrimson, Ellis, and Holman  
Former Asst Attorney General  
Former Deputy Commissioner of Revenue
- Fineberg, Richard  
Former Analyst - Division of Policy
- Floerchinger, William - Director, Oil and Gas Audit  
CPA  
Auditor - 10 years private industry  
25 years - IRS Tax Administrator  
2 1/2 years - Oil and Gas Audit
- Gault, Dr. John - Economist  
Geneva, Switzerland  
Emphasis on World Oil Prices
- Halloran, Mary - Director, Division of Policy  
Governor's Office

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11 years experience in Oil and Gas Audit

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Hellen, Partnow, and Condon

Former Attorney General for Alaska

Donohue, Joseph - Attorney

Preston, Thorgrimson, Ellis, and Holman

Former Asst Attorney General

Former Deputy Commissioner of Revenue

Fineberg, Richard

Former Analyst - Division of Policy

Floerchinger, William - Director, Oil and Gas Audit

CPA

Auditor - 10 years private industry

25 years - IRS Tax Administrator

2 1/2 years - Oil and Gas Audit

Gault, Dr. John - Economist

Geneva, Switzerland

Emphasis on World Oil Prices

Halloran, Mary - Director, Division of Policy

Governor's Office

Herman, Barbara - Asst Attorney General  
Supervisor, Oil, Gas and Mining Section

Higgins, Shelly - Asst Attorney General  
Oil, Gas, and Mining Section

Hotchkin, Michael - Asst Attorney General  
Oil, Gas, and Mining Section

Horst, Dr. Thomas - Economist  
Horst and Associates  
Emphasis on Pipeline Issues and Debit Allocation

Hosie, Spencer - Attorney  
San Francisco, California  
Emphasis on Petroleum Price Controls and Entitlements

Johnson, Jeff - Senior Revenue Auditor  
CPA  
10 years - Oil and Gas Audit  
2 years - Missouri Department of Revenue

Kinney, Bruce - Supervisor, Oil and Gas Audit  
15 years - IRS  
7 years - Oil and Gas Audit

Kissick, Wabe - Revenue Auditor  
18 years - Department of Revenue  
9 years - Oil and Gas Audit

Leitzinger, Dr. Jeff - Economist  
Micronomics, Inc.  
Los Angeles, California  
Emphasis on Value of Crude Oil

Loeffler, Robert - Attorney  
Morrison & Forester - Washington, D.C.  
Emphasis on Pipeline Issues

Malone, Hugh - Commissioner of Revenue  
Former Legislator  
Former Speaker of House of Representatives

Messenger, John - Attorney  
Preston, Thorgrimson, Ellis, and Holman  
Former Revenue Auditor  
Former Asst Attorney General  
Former Deputy Commissioner of Revenue

Nadel, Dr. Ernest - Economist  
Barakat, Howard and Chamberlin - Oakland, California  
Emphasis on Marine Transportation

Scott, Stacey - Senior Revenue Auditor  
CPA  
11 years - Oil and Gas Audit  
2 years - Johnson and Morgan (CPA's)

Stauffer, Susan - Revenue Auditor  
4 years - IRS  
11 years - Oil and Gas Audit

Tillery, Craig - Asst Attorney General  
Oil, Gas, and Mining Section

# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.  
JUNEAU, ALASKA 99801-1796  
PHONE: (907) 465-2400

March 16, 1990

The Honorable Cliff Davidson  
Chair  
House Resources Committee  
P.O. Box V  
Juneau, AK 99811

RECEIVED

Dear Representative Davidson:

This letter is in response to your communication of March 9, 1990, concerning legislation relating to oil and gas revenue disputes.

I have included a copy of the February 16, 1988 "Attachment B" and my December 7, 1989 response to Dr. Fineberg's letter. I urge you to contact Dr. Fineberg directly for a copy of his communication to me rather than calling upon the department to edit portions for distribution. Dr. Fineberg is in the Legislature's employ specifically with respect to this matter.

Amerada Hess Working Group meeting dates in chronological order, are as follows: March 10, 1987; April 15, 1987; September 8, 1987; September 14, 1987; October 20, 1987; November 4, 1987; November 20, 1987; November 26, 1987; February 16, 1988; May 3, 1988; August 31, 1988; October 5, 1988; December 5, 1988; February 1, 1989; March 7, 1989; August 23, 1989; October 12, 1989; January 26, 1990. In addition, there have been several Oil and Gas Subcabinet meetings which have pertained in part to Amerada Hess, most recently on February 16, 1990 and February 22, 1990.

I have personally been involved in the development of the Amerada Hess Working Group from its inception. I place great importance on the working group and have not delegated this responsibility to others. I assure you that initial review of settlement offers will be undertaken by the settlement team I have appointed. That team consists of Jim Eason, Director of the Division of Oil and Gas, Bruce Botelho, Assistant Attorney General, and Julian Mason, of Ashburn and Mason, an Anchorage-based law firm. This team is assisted by petroleum engineering and economic consultants. ^

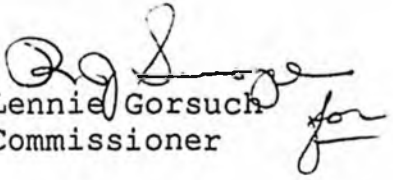
Representative Cliff Davidson -2-

March 16, 1990

recommendations toward settlement for this group will be reviewed by the litigation team and its consultants, headed by Wilson Condon. That team, which has undertaken the most extensive analysis of and aggressive posture toward royalty obligations, consists not only of attorneys, but of nationally recognized economists. This group would provide the most extensive "second opinion" on proposed settlements or settlement offers. I would also consult with other state officials who have particular expertise concerning the specific settlement as well as with the Governor and his staff.

Should you have additional questions regarding this matter, please let me know.

Sincerely,

  
Lennie Gorsuch  
Commissioner

Enclosures



# STATE OF ALASKA

HOUSE OF REPRESENTATIVES

Box V, Juneau, Alaska 99811

(907) 465-2487 • 465-2498

REPRESENTATIVE CLIFF DAVIDSON • DISTRICT 27 • Box 746, Kodiak, Alaska 99615 • (907) 486-8250

March 9, 1990

Lennie Gorsuch, Commissioner  
Department of Natural Resources  
400 Willoughby Ave. (Mail Stop 1000)  
Juneau, AK 99801

Dear Commissioner Gorsuch,

As you know, the House Resources Committee is considering legislation relating to oil and gas revenue disputes. To further our understanding of the management of the state's royalty litigation with oil and gas producers, I would appreciate your prompt response to the following questions:

1) The materials you provided Representative Cotten on October 17, 1989 included Attachment B (Settlement Principles of the Amerada Hess Working Group), adopted February 16, 1988 and modified on August 23, 1989. I would like to receive a copy of the February 16, 1988 document.

2) Dr. Richard Fineberg's report to the Legislature on oil and gas revenue disputes refers to a letter you wrote to Dr. Fineberg on December 7, 1989 (pp 37). Please provide a copy of that letter, and a copy of your December 7, 1989 response to Dr. Fineberg. If, in your judgement, portions of either letter should be held confidential, please delete those portions and briefly explain why each portion should remain confidential.

3) Please provide the dates of each meeting of the Royalty Litigation (Amerada Hess) Working Group since its creation in 1987. Please list each meeting date separately.

4) Please describe the review procedures that you would employ to evaluate a settlement with one or more of the defendants in this case. If there are any written procedures, please provide them.

In view of the time constraints we are facing, I would very much appreciate your response to these questions by the close of work on Friday, March 16 or sooner.

Thank you for your assistance. I look forward to discussing these matters with you in the coming weeks. With best regards.

Cordially,

A handwritten signature in cursive script that reads "Cliff Davidson".

Representative Cliff Davidson

Testimony before House Resources Committee  
Kenneth Reither, Exxon Company, U.S.A.  
Friday, March 23, 1990

Mr. Chairman, Members of the Committee. My name is Ken Reither. I have been an employee of Exxon Company, U.S.A. for something over 16 years. My primary emphasis during that period has been in the areas of state taxation. My office is in Anchorage. My purpose today is to comment on behalf of Exxon on House Bills 519, 541, 554 and 573 from a tax administration point of view.

First, some general comments. Exxon has for a number of years shared the concerns of the bill sponsors over the growing amounts of taxes in controversy in Alaska, the length of time required to obtain final resolution of these issues, and the structure of the resolution process itself. We believe, however, that the legislative bills being discussed today will not materially assist in solving the problem. We hope that some of the information provided today will help explain why.

Exxon last fall received revised workpapers and tax assessments for oil production taxes for 1979 through 1982 and corporate income taxes for tax years 1979 through 1981. The assessment documents and accompanying workpapers fill three banker's boxes and probably weigh at least 40 pounds. There are more than 25 separate issues identified in these papers, some very large, some small. Some are relatively straightforward, but some are extremely complex. The largest relate to how we determined the value that we reported for the oil produced.

With respect to these tax assessments, the administrative process in Alaska provides for an informal conference within the Oil and Gas Division of the Department of Revenue. If matters cannot be resolved at that level, the next step is a formal hearing conducted by a hearing examiner reporting to the Commissioner. If the taxpayer is not satisfied with the outcome of the formal

hearing, the taxpayer may appeal to the Alaska Superior Court, but in the normal case, the Superior Court is required to decide the appeal based on the record made in the hearing before the Department. The taxpayer is not entitled to a trial.

We are now at the informal conference level with respect to the assessments and workpapers received last fall. Exxon and the Oil and Gas Division of the Department of Revenue have both assigned teams to work on this matter. An assistant Attorney General has been assigned to assist the Oil and Gas Division. The discussions taking place are for the purpose of reaching a common ground as to why Exxon filed its returns the way it did, and why the Department believes we owe additional tax.

Once that common understanding is reached, we hope to go forward to resolve at least some of the issues at that level. Those issues not resolved at that level will then go to formal hearing and on to court if necessary. It is Exxon's hope that these further steps will not be necessary because we believe that further litigation is not in the interest of Exxon or the State. And however frustrating and long these discussions may appear, we are hopeful that these discussions will resolve the issues.

So far I have discussed the status of the revised tax assessments received last fall, which cover income taxes through 1981 and oil production taxes through 1982. As to our tax returns for subsequent periods, the Department's auditors have been visiting Exxon to examine our books and records, the methods we used to determine the oil values we reported, the transportation deductions we took, and the myriad of detail that went into preparation of our returns. It always has been and continues to be Exxon's policy to provide full disclosure and full access of our records to the

Department's auditors. We are not stonewalling and we have full detail available to support the calculations we made in determining the tax that we paid.

As a final general comment, we believe it would be helpful for you to know that Mr. Floerchinger is meeting with the Tax Committee of the Alaska Oil and Gas Association this coming Tuesday, March 27, 1990, for the purpose of explaining to Exxon and the other taxpayers new equipment acquired by the Oil and Gas Division and new procedures for gathering data, all designed for the purpose of streamlining the audit process.

Now I would like to turn to the specific provisions of the bills under discussion. One of the provisions of HB 519 would establish an Administrative Law Judge within the Department of Administration. As we have testified in past years, Exxon believes that changes should be made to the appeal process currently in place in Alaska. We concur in the notion that the Department finally determining the appeal should not be the same Department that came up with the tax assessment in the first place. The better solution is to allow trial in the Superior Court.

HB 519 would also raise interest rates on outstanding oil and gas tax assessments to 20%. We believe such a rate is too high. We believe it is not fair to apply one rate to the petroleum industry and a separate, lower rate to other taxpayers in the state. We also believe that this provision will not assist in resolution of the overall problem.

The other provision of HB 519 would require petroleum taxpayers to prepay disputed tax and royalty assessments in order to bid on oil and gas leases. We believe this provision will add considerations to the bidding process that are unrelated to the oil or gas prospects themselves, and the

result would have unintended and negative side effects for both industry and the State of Alaska. As Ed Phillips testified on March 21, this provision could result in fewer bids and smaller revenues for the State.

It is also important to keep in mind that these are disputed taxes that we are discussing -- that there are genuine differences between Exxon and the Department as to the amount of tax due. Payment of taxes and royalties and the assessment appeal process are totally unrelated to the lease bidding process. This provision smacks of being guilty until proven innocent.

HB 541 would establish a requirement for an independent appraisal of any major tax or royalty settlement before the settlement could go forward. It was suggested in testimony on Wednesday March 21 that a set of findings was envisioned and that it might be appropriate that the findings be made public.

As mentioned before, the assessment documents and workpapers received last fall by Exxon involve at least 25 separate issues, some exceedingly complex, and three banker's boxes of detail. It is going to take many months of discussion before resolution can be reached as to these issues. Requiring a separate independent analysis would only add another layer to an already complex and difficult task and would for all practical purposes bog down the process.

HB 554, including the amendment proposed March 21 by its sponsor, would allow disclosure of summaries of the business income and taxes paid of a taxpayer involved in the petroleum business in Alaska and would extend to all income, production, conservation, and property taxes paid by the petroleum industry in Alaska. First, only oil taxes are singled out for disclosure. Second, we do not see how such disclosure will materially assist in resolution of tax disputes, which is the real problem we understand these bills are

intended to address.

HB 573 provides for release of delinquent tax information in the case of large oil tax assessments relating to early tax years where the assessment has been on the books for more than a year and provides for escrow of half of the amounts assessed in order to apply for formal hearing. Again, Exxon does not believe that either provision will materially assist in the early resolution of tax disputes, but will instead set up artificial and arbitrary deadlines unrelated to the complexity of the tax issues themselves.

Exxon recognizes, however, that the Legislature does have oversight responsibility and we recognize the need for disclosure of information to the Legislature to assist in that responsibility. Exxon two years ago testified that we supported the development of legislation that would allow disclosure to members of the Legislature in an atmosphere where both the Department of Revenue and the taxpayer were present so that neither side was disadvantaged, and where appropriate safeguards were in place to preserve the confidentiality of the data disclosed. We continue to support that effort.

This concluded my comments. Thank you for the opportunity to testify.

TESTIMONY BEFORE HOUSE RESOURCE COMMITTEE  
ROBERT W. VAN HOOK, BP EXPLORATION (ALASKA) INC.  
FRIDAY, MARCH 23, 1990

FOR THE RECORD, MY NAME IS BOB VAN HOOK. I AM HERE TO TESTIFY FOR BP EXPLORATION (ALASKA) INC.

BP APPRECIATES THIS OPPORTUNITY TO TESTIFY ON H.B.'S 519, 541, 554, AND 573.

WHETHER THESE BILLS HAVE ACTUALLY BEEN PROMPTED BY RICHARD FINEBERG'S RECENT REPORT ON THE SO-CALLED "BACK TAXES" ISSUE OR NOT, THEY ALL SHARE WITH THAT REPORT AN IMPORTANT AND FUNDAMENTAL MISPERCEPTION ABOUT THE OIL INDUSTRY AND ITS ATTITUDES TOWARD THE STATE'S TAX ASSESSMENTS. THAT MISPERCEPTION IS THAT OIL COMPANIES ARE UNWILLING AND UNCOOPERATIVE IN TRYING TO RESOLVE THE TAX ISSUES THAT THE ASSESSMENTS HAVE RAISED. ASIDE FROM THE GENERAL CORPORATE GOALS OF TRYING TO AVOID ILL DEFINED RISKS, THERE IS A VERY STRONG PRACTICAL REASON - UNIQUE TO ALASKA - TO RESOLVE TAX DISPUTES QUICKLY.

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UNRESOLVED TAX ASSESSMENTS LEAVE THE ALASKAN TAXPAYER AT RISK FOR EVER-INCREASING TAX ASSESSMENTS UNDER NEW THEORIES WHICH THE STATE DEVISES YEARS AFTER THE ORIGINAL ASSESSMENT. THE ATTORNEY GENERAL HAS ADVISED THAT THE DEPARTMENT OF REVENUE MAY INCREASE THE AMOUNT OF TAX THAT IT CLAIMS IS OWED, EVEN AFTER THE STATUTE OF LIMITATIONS HAS OTHERWISE RUN OUT, SO LONG AS THE ORIGINAL ASSESSMENT IS STILL BEING APPEALED WITHIN THE DEPARTMENT AND HAS NOT GOTTEN TO COURT. WHILE WE DISAGREE STRONGLY WITH THE ATTORNEY GENERAL'S CONCLUSION, THE DEPARTMENT HAS USED THIS TACTIC TO FULL ADVANTAGE IN THE ABSENCE OF ANY COURT RULINGS ON THE SUBJECT.

IN ONE CASE WITH US, THE SECOND ASSESSMENT - WHICH CAME MORE THAN THREE YEARS AFTER THE FIRST ASSESSMENT - WAS FOR MORE THAN THREE TIMES THE AMOUNT OF THE ORIGINAL ASSESSMENT. HAD THE ORIGINAL ASSESSMENT BEEN RESOLVED WITHIN THAT THREE YEAR PERIOD, THE DEPARTMENT WOULD HAVE BEEN BARRED - EVEN UNDER THE ATTORNEY GENERAL'S OPINION - FROM MAKING THE SECOND ASSESSMENT. TO LIMIT THIS EXPOSURE, WE HAVE SERIOUSLY CONSIDERED SKIPPING OUR RIGHT TO INFORMAL CONFERENCE SIMPLY TO DECREASE THE CHANCE FOR NEW THEORIES TO BE DEVELOPED. IN PLAIN FACT THE DEPARTMENT HAS A GREATER INCENTIVE THAN THE TAXPAYER TO EXTEND THE RESOLUTION OF TAX DISPUTES.

PAGE 3 OF 7

THE SLOW PACE OF RESOLVING OUR ALASKAN TAX AND ROYALTY ISSUES IS ATYPICAL FOR BP.

CONSIDER THAT IT WAS NOT UNTIL OCTOBER 1989 THAT BP FIRST SAW THE AMOUNT THAT THE STATE BELIEVES IT IS OWED UNDER THE AMERADA HESS CASE. THIS MEANS THAT IT TOOK THE STATE 12 YEARS TO TELL US HOW MUCH IT BELIEVES ROYALTY OIL WAS WORTH THAT WAS PRODUCED IN 1977. ASK YOURSELVES WHAT PREPAYMENT, PUNITIVE INTEREST RATES, BIDDING RESTRICTIONS OR BIASED PUBLIC DISCLOSURE HAS TO DO WITH A PROCESS THAT CAN JUSTIFY A 12 YEAR PERIOD FOR ASSESSING.

IN 1988, BP TESTIFIED IN FAVOR OF LEGISLATION WHICH BP BELIEVED WOULD PROVIDE FOR A QUICKER AND MORE EVEN HANDED RESOLUTION OF TAX DISPUTES. IN A NUMBER OF AREAS, THERE WAS STRONG DISAGREEMENT BETWEEN THE INDUSTRY AND THE DEPARTMENT OF REVENUE. THE ONE AREA OF AGREEMENT WAS THAT THERE NEEDED TO BE MORE FACE TO FACE CONTACT BETWEEN THE DEPARTMENT AND INDUSTRY.

GREATER CONTACT HAS IN FACT OCCURRED. SOME PROGRESS HAS BEEN MADE IN RESOLVING ISSUES IN ASSESSMENTS, PRIMARILY IN CONFIRMING THAT TRANSPORTATION COSTS REPORTED HAD IN FACT BEEN INCURRED. NEITHER THOSE WE DEAL WITH IN THE DEPARTMENT NOR BP BELIEVES ENOUGH PROGRESS HAS BEEN MADE, HOWEVER. OVER THE

PAST 2 MONTHS, BOTH SIDES HAVE TAKEN A FRESH LOOK AT NEW APPROACHES TO BREAKING THE LOG JAM. BP IS CAUTIOUSLY OPTIMISTIC THAT FURTHER PROGRESS CAN BE MADE. BP HAS ACTED WITH THE UTMOST DILIGENCE AND GOOD FAITH DURING THESE NEGOTIATIONS AS HAS THE DEPARTMENT. I WOULD BE STUNNED IF ANY DEPARTMENT EMPLOYEE WORKING WITH BP OVER THE PAST THREE YEARS WOULD DISAGREE.

THE PUNITIVE MEASURES SUGGESTED IN THIS LEGISLATION AND IN RICHARD FINEBERG'S REPORT AND TESTIMONY ARE A TRULY DISAPPOINTING RESPONSE TO OUR GOOD FAITH EFFORTS. AS FAR AS I KNOW, RICHARD FINEBERG IS NOT IN THE DEPARTMENT OF REVENUE AND HAS NOT BEEN WITHIN 571 MILES OF OUR NEGOTIATIONS. HIS SECOND OR THIRD HAND SOURCES ARE MISINFORMED OR HE HAS MISUNDERSTOOD THE EXPLANATION. WITH RESPECT TO HIS COMMENT ABOUT INDUSTRY HABITUALLY UNDERPAYING TAXES, I WOULD POINT OUT BP'S AVERAGE REPORTED PRICE ON ITS TAX RETURNS EXCEEDED THE AVERAGE OF THE SPOT VALUES WHICH THE COMMISSIONER USED IN HIS GRAPH TO DEMONSTRATE THAT COMPANIES ARE CURRENTLY REPORTING BELOW SPOT VALUES. THE COMMISSIONER'S SCHEDULE COVERED JULY THROUGH DECEMBER OF 1989.

IN H.B.'S 519 AND 573 AND IN THE FINEBERG REPORT, PREPAYMENT PROPOSALS ARE MADE. THE FOUNDATION FOR THESE PROPOSALS IS EXTREMELY SHAKY.

FIRST, THE TAXPAYER IN MANY INSTANCES MAY NOT KNOW WHAT HIS ASSESSMENT SHOULD BE UNDER THE STATE'S CURRENT INTERPRETATION OF THE TAX LAWS. ON A NUMBER OF CRUCIAL ISSUES, THE STATE HAS ALTERED ITS INTERPRETATIONS OF THE LAW AFTER THE ORIGINAL AUDIT WORK HAS BEEN DONE. NEW AUDIT WORK IS THEN REQUIRED TO SQUARE THE ASSESSMENT WITH THE THEORY.

SECOND, BP BELIEVES THAT IT HAS PAID THE PROPER AMOUNT OF TAXES AND ROYALTIES AND DISAGREES WITH THE THEORIES ADVANCED BY THE STATE. YET EVEN IF THE STATE'S THEORIES WERE CORRECT, THE ASSESSMENTS ARE HIGHER THAN CAN BE JUSTIFIED UNDER THOSE THEORIES. EVEN THE FINEBERG REPORT ACKNOWLEDGES THAT THE ASSESSMENTS ARE IN THE NATURE OF A JEOPARDY OR BLUE SKY ASSESSMENT. AN EXAMPLE WOULD BE THE DISALLOWANCE OF AN ENTIRE CATEGORY OF EXPENSE SIMPLY BECAUSE OF DISPUTE ABOUT 5% OF THE TOTAL.

THIRD, FORCING A TAXPAYER TO ESCROW DISPUTED TAXES WITHOUT A HEARING AND WITH FULL KNOWLEDGE THAT THE ASSESSMENT IS TOO HIGH IS A CALLOUS DISREGARD OF THE FUNDAMENTAL RIGHTS TO DUE PROCESS AND TO PETITION GOVERNMENT FOR REDRESS OF GRIEVANCES.

WITH RESPECT TO H.B. 541, BP ENCOURAGES LEGISLATIVE OVERSIGHT OF THE SETTLEMENT PROCESS. E.G. BP WOULD FULLY SUPPORT CONFIDENTIAL BRIEFINGS OF A LEGISLATIVE COMMITTEE WITH OR

WITHOUT THE DEPARTMENT OF REVENUE PRESENT PROVIDED THE PROCESS IS FAIR TO BOTH SIDES AND THERE ARE ADEQUATE SAFEGUARDS TO PROTECT CONFIDENTIALITY. BP STRONGLY OBJECTS TO DEPARTMENT OF REVENUE BRIEFINGS ABOUT BP MATTERS WITHOUT THE THE OPPORTUNITY TO BE PRESENT AND WITHOUT ANY REAL SAFEGUARDS IN PLACE.

WHILE SUPPORTING LEGISLATIVE OVERSIGHT, BP OPPOSES THE REQUIREMENT FOR YET ANOTHER INDEPENDENT APPRAISAL. CURRENTLY BOTH THE DEPARTMENTS OF REVENUE AND LAW AND PERHAPS THE OFFICE OF MANAGEMENT AND BUDGET MUST APPROVE A SETTLEMENT. ADDING A THIRD OR EVEN FOURTH LEVEL OF STATE REVIEW IS UNREALISTIC AND WILL PROBABLY DELAY FINAL RESOLUTION OF "BACK TAXES" EVEN MORE. EACH STATE GROUP WILL HAVE TO JUSTIFY ITS ROLE IN THE PROCESS AND DISPUTES AMONG THE STATE PARTIES MAY BE MORE INTENSE THAN DISPUTES WITH THE TAXPAYER.

A BETTER APPROACH WOULD BE AT THE OUTSET TO PICK A STATE TEAM WHICH YOU TRUST. SPEND YOUR TIME IN OVERSIGHT ACTIVITIES, NOT SECOND GUESSING THE TEAM WITH STILL ANOTHER GROUP. THE FINEBERG REPORT AND TESTIMONY DO NOTHING BUT RIDICULE ANYONE WHO WOULD REACH A SETTLEMENT, BUT THEN BEMOANS THE SLOW PROGRESS. TRY SUPPORTING YOUR TEAMS INSTEAD OF DOUBTING THEM AT EVERY TURN.

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WITH RESPECT TO THE OTHER PROVISIONS IN THE BILLS BEFORE YOU SUCH AS NON-MARKET INTEREST RATES, LIMITATIONS ON LEASE BIDDING, BIASED PUBLIC DISCLOSURE, ETC., BP CONSIDERS THESE SIMPLY AS PENALTIES FOR IMAGINED TRANSGRESSIONS OUTLINED IN THE FINEBERG REPORT AND TESTIMONY. BP'S PACE IN ISSUE RESOLUTION IS DICTATED BY THE TIME IT TAKES TO REACH CORRECT SOLUTIONS, INCLUDING THE TIME IT TAKES FOR THE STATE TO DIGEST THE INFORMATION WE PROVIDE THEM.

THANK YOU FOR THIS OPPORTUNITY TO TESTIFY.