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LEGISLATIVE INFORMATION OFFICE

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BP/AMOCO PURCHASE OF ARCO

Good evening and thank you for allowing me to provide these comment. My name Keith Hand and I am CFO of Fairbanks Natural Gas representing Ray Latchem, President who is traveling. The following testimony will also be provided in written form for entry into the record.

In representing Fairbanks Natural Gas and the current and future users of natural gas in the Interior, I wish to express the following two concerns regarding the BP Amoco purchase of ARCO: the effect of this combination will have on the current and future gas supply contracts Fairbanks Natural Gas has with ARCO, and the impact this buy-out will have on the development of the North Slope Gas.

- Fairbanks Natural Gas has developed relationships with the personnel at ARCO, which led to the acquisition of a desirable gas supply agreement for Cook Inlet gas. This ARCO gas is what is liquefied and transported and distributed to the residents of Fairbanks. Prior to this acquisition, BP/Amoco did not have a presence in any natural gas development in Cook Inlet. Therefore, it is undetermined what the new combined company's interest in Cook Inlet gas will be.
 - Of a more immediate impact, is the effect this purchase may have on our current gas supply contract. At this time, we realize that the Interior residents are currently a small consumer of the overall gas demand in the state, but the future of our project depends on such supply contracts. This contract was and remains a critical component of our utility permit as issued by the Alaska Public Utilities Commission.
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- Also this combination reduces the natural gas producers by one major entity, so the competition in the future will be more weighted to the producers side of the table. Less suppliers equates to less bargaining power for consumers, whether it is us acting as the gas utility or when it is passed through to our customers. A small entity such as ourselves without the benefit of the ARCO relationships may find it difficult to negotiate a renewal to our existing contract on favorable terms especially with one less supplier in the marketplace.
- Secondly, I'll address the often-discussed future use of North Slope natural gas. Speaking for the residents of the Fairbanks area, we will have a substantial reduction in energy bills if the natural gas pipeline is constructed - we estimate current home heating prices will be reduced to half of what they are now. The facts are that ARCO BP and Exxon are the majority owners of the gas on the North Slope. ARCO is one of the key members of the Ak North Slope Gas project sponsor group that is researching the feasibility of a natural gas pipeline feeding a LNG Plant. While ARCO has been very active in development of a gas pipeline, BP has been silent in regards to a pipeline, instead focusing its efforts on a natural gas to liquids process which would utilize the existing oil pipeline. While both companies previously agreed that there is enough North Slope gas for both projects, BP/Amoco has already spoken on what alternative it is pursuing - The GTL plant - Once combined, one must wonder if the company will stay committed to its statement in the papers claiming to continue the dedication of resources to the gas pipeline & LNG support group it has rebuffed up to this point. If history speaks, BP/Amoco will probably not promote the delivery of cheap gas supplies to the residents of the interior.

Thank you for your time.

Key concerns arise from BP-ARCO deal

In BP Amoco's merger with the Atlantic Richfield Co., benefits for private owners are clear. Arco is a prize.

But what's in it for the owner state? Since we opened Prudhoe Bay, Alaska has never faced a test like this.

Today, combining BP Amoco's leases with Arco is against Alaska law. Should we change our law? We limit the acreage any one company can lease to 500,000 acres — and this merger covers close to 800,000.

As a right-of-way owner for the pipeline from the North Slope, what's our position on Trans-Alaska pipeline system ownership? Should we approve the proposed change?

We are also a taxing authority. BP Amoco paid a 25 percent premium for Arco over its current stock price. Do those premium market values reflect a new value for assets we tax on the North Slope, the pipeline and in Valdez?

Given the price paid, maybe the pipeline is now assessed at a depreciated rate far below its actual value.

What will happen to the gas on the North Slope?

BP Amoco's big position in gas worldwide may be good for Alaska. Getting value from gas requires technology, and now BP has acquired some of the best — in both LNG (liquefied natural gas) and new processes to convert gas to white diesel (so-called



WALTER J. HICKEL

gas-to-liquids.) The company's gas technology group will be moved here. And a new gas-to-liquids plant on the Slope may answer more questions.

The sponsor group Arco formed to explore the LNG option will continue — though BP spurned it just last year. BP Amoco officials say they do not believe Alaska North Slope LNG is competitive in Pacific markets. Can Alaska afford to leave its gas in the hands of an operator who controls alternative supplies, outside Alaska, to serve that market for 20 years or more?

What are the impacts on national security?

We understand Alaska's oil and gas is strategic for the United States. Whether we use it here, or export it, producing energy keeps us strong as a nation. When we trade abroad, we keep friends abroad.

The prize BP Amoco found

in Arco included 8 trillion feet of gas Arco owns in Indonesia. Our North Slope has more than four times that, and many believe our gas can be competitive with new projects planned in Indonesia, Russia, China, Australia. The national security element again begs the question: Should we free Alaska gas to compete on its own in the world market?

How can we get billions of dollars in LNG trade started with Asia, to help the United States and Alaska, even if BP Amoco could make more money selling gas from elsewhere?

What will happen to competition for new opportunities on the North Slope?

Until now, Arco and BP have pursued aggressive — but different — strategies in Alaska. That helped us.

If we believe the North Slope is in decline, we all might benefit from the lower cost structure the merger provides. If we still think of Alaska as a frontier, with more big discoveries to be made, we might value competition more.

To hedge that bet, should we insist ownership of the pipeline, or at least Arco's share, be structured so newcomers to the North Slope oil game are not at a competitive disadvantage? Should the state consider owning part of the line?

Then what are indirect impacts on Alaska's jobs?

Are more layoffs to come,

beyond those announced? With this merger, will Alaska's oil field workers, employees and contractors suffer? Is now the time to improve assurances in place for Native and local hire?

I believe this merger will happen. I believe BP Amoco's assurances that it takes its new role in Alaska's future seriously. But Alaskans have the obligation as owners to ask what's in it for us, and to seek the best deal.

Arco is a pioneer with its heart in our pioneering country. BP, formed in part by Winston Churchill, has a great business, social and environmental record here and worldwide. If so much of our common wealth is tied to one company, BP Amoco is a good one.

Questions we've raised are just questions. Alaskans need a specific plan of action we can support. The BP Amoco-Arco merger will help us focus on a long-term view of how to maintain Alaska's economic vibrancy.

Gov. Knowles, the current "foreman of the ranch" here, represents us owners. He has a big job ahead, and so does the Alaska Legislature. Our leaders must formulate a plan. Alaskans should stand ready to help them complete the job in our best interest.

□ Wally Hickel was secretary of the Interior and governor of Alaska for two terms.

4/15/99

4/15/99

Jerry McCutcheon Testimony 4/15/99

You can kiss the Gasline good bye. It will not fly. That is the last good thing I will have to say about the merger. I have fought the gasline for almost 25 years.

The BP / ARCO merger will result in a colossal screwing of Alaskans. It is BP's corporate responsibility to screw Alaska legally or ILLEGALLY. The shotgun wedding of Amoco and BP moved BP up into the class with Royal Dutch Shell and EXXON. Both Shell and Exxon have lost interest in Alaska and withdrawn from Alaska because Alaska has matured as an oil province and no longer fits its' financial recourses and political power of EXXON and Shell. EXXON is maintaining minimal personnel in Alaska ; just enough to keep ARCO honest in overseeing ARCO's production of the EXXON / ARCO leases. Alaska has been BP's cash cow which allowed BP to swallow up Amoco and others. Now ARCO!

ARCO is a company which not only fit's Alaska, although a tight fit, but more importantly a company which needs Alaska's oil for ARCO's west Coast refineries both today and tomorrow. ARCO used Alaska as a cash cow to further ARCO world dreams, but ARCO ,with only half Alaska's oil that BP has, not only got into trouble on the world stage but also lost ARCO's ability to handle small prospects. ARCO forgot it origins, in ARCO's heady flow of cash from its cash cow, Alaska.

ARCO was weathering the storms of ARCO's indiscretions, ARCO learned its' lessons and ARCO would have survived nicely but the prolonged depression of the price of oil was more than it apparently wanted to withstand.

The State of Alaska should buy ARCO . ARCO is almost a perfect fit with Alaska's need for an oil company large enough to undertake any of Alaska projects and small enough to pursue Alaska's smaller prospects, but not its' smallest prospects.

The ARCO sale is not yet a done deal; if it were we would not be here today. Again the State of Alaska should buy ARCO. ARCO is a company that has learned its' lessons, but apparently too late to save itself and be the forceful company ARCO's current board directors believe ARCO should be. Alaska does not have to manage ARCO like the Alaska Railroad and the Alaska Ferry System. Alaska's ownership should be that of a large shareholder; and it may probably be best if Alaska did not own all of ARCO.

It is far better to own ARCO, a very profitable oil company that is currently strapped for cash, than become an owner in "The Gasline" who's prospects for profitability are so bleak that the owners of the gas do not want to construct the gasline; even with the State giving up the State's royalty gas and severance taxes; forcing the Cities along the proposed pipeline route to forgo their taxes which the Cities will need to pay for the increased cost of government due to the construction of the gas pipeline.

Cash for an ARCO acquisition has never been cheaper. Buying ARCO is not a difficult acquisition to structure; it is a far simpler than the unprofitable gasline that all of you have been thrashing around trying to force into being.

A legislator who wants to buy into a gasline, with bleak, at best, prospects for profitability, and yet does not want to buy a very profitable oil company is called many things, among them a sociopathic hypocrite in need of a Psychiatrist.

BP, with the acquisition of Amoco, joins EXXOX and Shell in seeking their fortunes where only BP's new found and financial recourses and political power can exploit. BP will leave Alaska; not like Shell who has almost sold out nor like EXXON who has minimal staff to oversee the residual of EXXON's asset, but more slowly. BP will milk BP's cash cow for all it is worth, they will milk Alaska so hard BP will kill it both figuratively and literally. BP will plot and time the final collapse of BP cash cow with BP's departure.

BP will use a Decision Tree and Monty Carlo analysis to exploit Alaska just like it does any other prospect. BP will batter and batter Alaska. When one partner knows a divorce is coming, they tell the other party everything they want to hear while they chip away elsewhere and exploit what is left of the relationship until it finally collapses.

BP will not only be a worse "alleged partner" for it is their corporate responsibility to exploit Alaska but also BP will have a parade of shills seducing Alaskans into believing BP is really looking after Alaska's best interests. It will be like the last days of the canned salmon industry, only much worse. The cost of buying Alaska's political offices, press and judiciary does not even rise to the level of BP's pocket change.

BP's oil pipeline screwing of Alaska, cost Alaska \$5 billion by 1987 and will cost Alaska \$40 billion by 2010.

BP et al gut and run almost wrecked Prudhoe Bay oil recovery excepted they got caught. Recovery would have dropped to 5 billion barrels.

BP did wreck Badami. I do not know the roll BP played in Lisborn.

BP put on a "staged" construction of North Star modules, which they never intended to complete, to fool the public and was very successful at it with help of the press and a phony baloney law suit.

BP lied Alaskans about the producibility of Prudhoe Bay, BP told Alaskans Prudhoe would produce 9.6 billion with or without a gasline but told congress 15 billion without a gasline. Public Document 95-73 page 570. With cooperation of the press and the legislature BP continues to fool the only too willing public. That producibility had risen to 17 billion barrels before 1989, with 1970's technology. And if the current roomers are correct the produceibility is now 20 billion.

What's Next for the Oil Industry

I am Randy Ruedrich with Arctic E&P Advisors in Anchorage. I have been associated with the Alaskan petroleum industry since 1969. I have a PHD in Chemical Engineering and have managed various drilling, production, transportation and research organizations in the US, Europe and the Middle East. My drag reduction research lead to the highly successful Alyeska throughput increase in the 1980's.

Today I will share my thoughts on the impact of the combination of ARCO and BP Amoco on Alaska and Alaskans.

Operations: Our industry can best be characterized as ever changing. The exploration, discovery, development, depletion and abandonment phases are the required changes in every successful oilfield. Petroleum exploration and production is a classic commodity production enterprise. Low cost operations are mandatory in a competitive world market. The successful commodity producer must maximize production while minimizing cost in all phases of an oilfield's life.

A company or group of companies may lease exploration acreage from various landowners. The lease boundaries are linked to surface features and surveys. A single bid group in a competitive sale may not succeed in acquiring all the leases over a prospect. Therefore the oil accumulation is trapped geologically thousands of feet below the surface under adjacent leases owned by different owner groups. Petroleum law that reflects efficient business practice encourages all leaseholders to combine their subsurface resources and select a single owner to be the unit operator. The unit operator, with working interest owner approvals, conducts design, construction, drilling and production operations. For large discoveries, the working interest owners may agree to multiple unit operators rather than a single operator. The Prudhoe Bay Unit owners selected two operators ARCO and BP to develop and produce their significant resources.

Most of the Cook Inlet fields started with two or more unit and/or sub-unit operators. As the production in each Cook Inlet field declined, each unit reduced its cost by eliminating the multiple operator overheads. Recall Mobil, Amoco, Arco, Marathon and Unocal turned over platforms and related facilities to Unocal and Marathon after 1980.

The Prudhoe Bay Unit started similar operator consolidation to improve efficiency as the work scope declined. In 1992 the Prudhoe Bay Unit created Shared Services for Drilling, Construction, Aviation and Road/Pad Maintenance. The Alaskan oilfield service community adjusted to these changes just as it had adjusted to the Cook Inlet changes. Shared Services and related ARCO and BP operational changes reduced total production costs and produced an increase in drilling investment capital from 1994 to 1998. The PBU production decline rate

was minimized. That was great for the oilfield service community, individual Alaskans and the State. We had more activity, more jobs, more oil production or more State revenue.

A single PBU operator or more Shared Services would historically follow as unit production continued to decline. In the relatively near future, a single operator would have been contracting and procuring for PBU. The long term central North Slope scenario would have a single operator deplete the existing fields to maximizing production and recovery while minimizing cost. The commodity business model requires this series of changes.

The BPA/Arco combination simply accelerates these events for the long-term benefit of Alaska and Alaskans.

Ownership: The combination of Arco and BPA ownership effects the following five aspects:

Continuing development plans in PBU, KRU, MPU, Endicott, Alpine and Badami.

BPA can be expected to perform within the limits of world oil economics as any prudent owner does. The maximum annual capital investment in any field has always been limited by the least aggressive owner's capital plan. The elimination of Arco ownership should be a positive impact on investment. More investment capital will flow to our major North Slope fields if BPA successfully reduces operating cost. The only loss is Arco's technical input that can be offset with other working interest owner input.

Exploitation plans for the identification of additional reserves in the existing units.

This critical activity has produced recent discoveries such as Aurora, Midnight Sun, Northwest Eileen, Northwest Niakuk, Tabasco and Tarn. This work produces oil quickly and at reasonably low cost. This work must continue at its current rate or even be accelerated. Recall ARCO Alaska President Ken Thompson suggested that there are 50 or more prospects in the existing units. BPA will have a tremendous exploitation workload. What can or should the state do? How about a tax credit for accelerating exploitation wells drilled in the PBU, KRU, DIU and MPU. If in the past three years BPA and ARCO drilled five exploitation wells in the typical year, how about a fifty percent tax credit for exploitation wells in excess of seven. This tax credit will drive BPA to get the exploitation job done sooner, probably look at a broader range of prospects, put more oil in the pipeline and more revenue to the State.

Exploitation plans for Alpine, North Star, Liberty, Sourdough, etc.

The state should simplify the permitting process. It would be a positive sign to potential Alaskan lease sale bidders that Alaska is a good place to invest their capital. This will make future open Alaskan acreage more valuable.

Exploration plans for new reserve identification.

High exploration and development costs and the short winter exploration season limit exploration drilling. The North Slope needs more eyes and bankrolls to look at prospective acreage. With its immense and extremely important exploitation workload noted above, BPA will be pressed to look at even 500,000 acres of exploration acreage. BPA should be allowed to sell the balance of the onshore acreage as defined by state law. The benefits to Alaska are

New exploration efforts with different concepts on BPA lowest priority acreage
Independent financial resources and dry hole budgets

One or more significant companies added to Alaskan economy

Gas development plans for gas monetization. We have an immense gas resource that can supply several major markets. Since 1996 as a UAF Petroleum Engineering Advisory Committee member, I advocated that Alaska becomes the world leader in Gas To Liquid (GTL) technology. Let's establish a plan to develop commercial GTL plants within a defined stable tax regime and start GTL production. GTL plants can be built in Anchorage and/or on the Kenai and shipped to the Slope over a multiple year period. Talk about a long term Alaskan win-win plan-active Alaskan construction contractors, Alaskan jobs and several tankers of white crude leaving Valdez each week would be great for the Alaskan economy and the State Treasury. Further the white crude would help keep the TAPS pipeline open for many extra years to ship billions of extra barrels of crude oil from discovered and undiscovered North Slope oilfields.

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To	Rep Barnes	
Co.	WORLD TRADE	
Dept.	CONA	
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4/15/99

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April 15, 1999

Representative Ramona Barnes, Chair
 House Special Committee on World Trade and State/Federal Relations
 Alaska State House of Representatives
 State Capitol, MS 3100
 Juneau, Alaska 99801-1182

Dear Representative Barnes:

Thank you very much for giving me the opportunity to participate in your hearing tonight on the proposed ARCO-BP merger. I prepared the attached report, "State Ownership of TAPS: Why It Should Be Considered and How It Would Work," which recommends State ownership of TAPS as a condition of the proposed merger, as an independent consultant. This proposal is being submitted to the Attorney General's task force on behalf of the Alaska Public Interest Research Group, the Alaska Forum for Environmental Responsibility and Oilwatch Alaska.

I prepared this report because I realized that not everyone has had the opportunity to observe FERC pipeline tariff proceedings or the State's role in those proceedings. This report therefore provides background information and sources regarding key TAPS tariff issues, then presents a scenario in which the State :

- acquires TAPS without outlay of State revenue;
- operates the pipeline on a non-profit basis, reducing TAPS tariffs significantly, thereby increasing State revenue;
- uses some pre-collected DR&R funds to fulfill capital repayment, as necessary, as well as specific environmental tasks;
- promotes — and ensures that TAPS does not stifle — competition;
- guarantees pipeline revenue for the communities through which TAPS passes; and
- escrows TAPS DR&R funds.

While the broad outlines of this report are clear, it should go without saying that these are extremely complicated issues. The devil is — as always — in the details, and we fully recognize that many aspects of this proposal bear further scrutiny. As the report indicates, modelling of

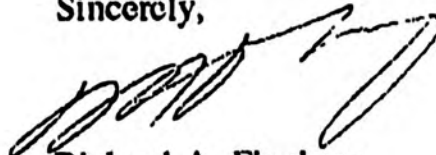
*Fineberg / Rep. Barnes
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specific tariff elements is necessary. However, I am confident that the numbers I have provided give a conservative estimates of the short-term benefits to the State. I further believe that these benefits should continue to prevail in the long-term scenarios.

I hope you will receive a copy of this proposal in time to share it with members of your committee, and that the information it contains will be of use to you in your deliberations regarding this important issue. I will try to be available at the Fairbanks Legislative Information Office tonight at 5 p.m. in case you and members of the committee have any questions.

In the meantime, thank you again for your consideration

Sincerely,



Richard A. Fineberg

State Ownership of TAPS: Why It Should Be Considered and How It Would Work

A Report to the Alaska Forum for Environmental Responsibility and Oilwatch Alaska

By Richard A. Finberg

April 9, 1999

Introduction

This report gathers information from a variety of studies relating to Trans-Alaska pipeline System (TAPS) tariff issues to fulfill two basic purposes: (1) To help concerned citizens and policy makers understand the problems posed by centralized control of the Trans-Alaska Pipeline System (TAPS) by the major North Slope producers; and (2) To make the case for Owner divestiture and State purchase of TAPS as conditions of approval for the ARCO-BP merger.

The first part of this report discusses the proposed ARCO-BP merger in the context of recent developments on the North Slope and the importance of the Trans-Alaska Pipeline (TAPS) to that development. The second part makes the case for purchase of TAPS as possible solution to some of the major problems identified in this report that would be exacerbated by the ARCO-BP merger.¹ The conclusion summarizes the benefits of State take-over and operation of TAPS.

Part I: The Problem

A. The ARCO-BP Merger and Recent Developments on Alaska's North Slope

In its 1996 final report, the Governor's Oil and Gas Policy Council worried that "over 95% of non-royalty oil is owned by three major integrated oil companies (ARCO, BP and Exxon). Two of these companies

¹ This report suggests that the ARCO-BP merger should not be approved without complete divestiture of TAPS by North Slope producers and companies with working interest in North Slope production; because other problems associated with the proposed merger are not considered, this report does not make a recommendation for or against the proposed merger.

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operate all of the North Slope fields." The Council believed that "having more oil industry participants would be advantageous for the State," and that "Alaska would benefit from more oil and gas players — large, medium and small."²

Between 1991 and 1997, six major oil companies left the North Slope; five of them turned over North Slope leases with discoveries capable of production in paying quantities to ARCO and BP. This pattern suggested the possibility that the major TAPS Owners — ARCO, BP and Exxon — might be using the pipeline to drive out their competitors. During this period, another North Slope producer sold its production interests to a smaller company, Forcenergy. Exacerbated by an extended period of low oil prices in 1998 and the first two months of 1999, consolidation in Alaska's oil patch has continued. ARCO took over Union Texas; BP bought Amoco, a major U.S. producer with minor production interests at Endicott; Exxon and Mobil announced their plans to form the world's largest oil company; low oil prices recently pushed an over-extended Forcenergy into bankruptcy. If Forcenergy cannot emerge from bankruptcy as a viable company, the list of players on the North Slope will be narrowed still further.³

The result of this stunning consolidation will be a corporate powerhouse capable of determining almost single-handedly the future of Alaska's most important revenue-generating industry. With ARCO's interests subordinated to those of BP by the proposed merger, some observers believe that Exxon — at present the third major North Slope producer as ARCO's silent partner at Prudhoe Bay — might decide to sell out and leave Alaska. Would any other company be willing to buy Exxon's

² Alaska Oil and Gas Policy Council, *Report to the Governor* (Juneau: Office of the Governor, February 1996), p. 11.

³ Portions of this background material are drawn from: Richard A. Finberg, "BP-Arco merger burns stakes for us all," *Anchorage Daily News*, April 6, 1999 (electronic edition). For the departures from the North Slope between 1991 and 1997 of major oil companies who found or produced oil on the North Slope, see Richard A. Finberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope* (Anchorage: Oilwatch Alaska, 1997), pp. 5.32-5.49.

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interest in the North Slope? It has proven difficult for the State to regulate the North Slope effectively with just three major producers; the task would become virtually impossible if the field is narrowed still more.

Consider the power of the BP-ARCO combine to dictate its own economic terms: If BP-ARCO disagrees with the State's position on a fiscal matter or simply wants a greater share of the revenue from a new field, the proposed new international oil giant could threaten to divert its capital to projects elsewhere around the globe.

What environmental stipulations will be attached to new projects, necessary repairs, equipment upgrades and ongoing maintenance for the aging pipeline? What about double-hulled tankers, required by the Oil Pollution Act of 1990 under an incomprehensibly slow schedule? If the State asks BP-ARCO to spend more on these and other environmental amenities, the new behemoth might respond by directing its dollars to investment in places with less stringent environmental standards.

From industry jobs to development of North Slope natural gas, Alaskans will be directly affected by the decisions of one company. Because the new giant would be headed by directors based in London, the proposed merger also raises significant national security concerns. Apart from Alaska's interests, should ownership of one-fifth of the nation's domestic oil production and the land link to that production province be controlled by a foreign corporation?

Although North Slope production is in decline and oil prices dipped to historic lows during 1998, the economic stakes in the North Slope are extraordinarily high for all Alaskans. When I examined North Slope profitability last year, I discovered that during the 22 years since the North Slope and the pipeline operations began operating, those facilities have generated greater profits than any corporation in the nation, save one: Exxon itself. The environmental stakes are high, too. The three companies that reaped the lion's share of this bonanza also indulged in unnecessary and unwise cost-cutting, thereby delivering the worst oil spill in this nation's history. The industry was aided and abetted by lax

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oversight on the part of the State and Federal governments, who were also major beneficiaries of the money.⁴

B. Pipeline Regulation, the 1985 TAPS Tariff Agreement and Antitrust Issues

A key aspect of any challenge to the ARCO-BP merger is likely to be the control by North Slope producers of TAPS. Historically, oil pipelines have been regulated to prevent pipeline owners from discriminating against non-owners, thereby creating a barrier preventing market entry by non-owners of the pipeline. In 1977, the newly-created Federal Energy Regulatory Commission (FERC) inherited authority for oil pipeline regulation from the Interstate Commerce Commission. Because of its isolation and distance from potential markets, knowledgeable observers have viewed the Trans-Alaska Pipeline (TAPS) as a classic example of a pipeline with high monopoly potential.⁵ The proposed ARCO-BP merger places 72% of TAPS in the control of one company. The latest consolidation move on the North Slope raises this question: In view of the pattern of transfer of North Slope discoveries and production interests and discoveries to major TAPS Owners, unless TAPS is operated by an entity that does not have production interests on the North Slope, can Alaska reasonably expect companies other than BP to invest in the North Slope?⁶

⁴ For economic analysis of North Slope production and pipeline operations compared to major U.S. corporations see: Richard A. Fineberg, *Praise the Pipe and Pass The Money: Facts and Reflections on Big Oil in Alaska Ten Years after the Exxon Valdez Spill* (published by the author, March 1999), pp. 17-22 and *How Much Is Enough: Estimated Industry Profits from Alaska North Slope Production and Associated Pipeline operations, 1993 - 1998* (Anchorage: Oilwatch, December 1998 (preliminary report)).

⁵ For a summary of U.S. pipeline regulatory history, see *The Big Squeeze*, pp. 3.1-3.5, 3.16-3.19 and 3.24-3.26.

⁶ Inter-state shipments through TAPS are regulated by the Federal Energy Regulatory Commission (FERC); intra-state shipments are regulated by the Alaska Public Utilities Commission (APUC). Pipeline regulation takes place principally in the form of approval of tariffs, or maximum per-barrel shipping charges, which are filed annually at FERC and at the APUC. TAPS tariffs are filed in accordance with a formula known as the TAPS Settlement Methodology (TSM), which was established in 1985 by an agreement between the State and the TAPS Owners (Carriers), ending a decade of tariff litigation. FERC approved the TSM formula through the year 2011, with renegotiations beginning in 2006. For intra-state shipments, APUC approved TSM historically but declined to endorse the tariff framework for future years; at APUC, TAPS tariffs are approved annually on an interim or *ad hoc* basis, subject to challenge. In 1998 Tesoro Alaska Petroleum Co. initiated a proceeding at APUC challenging the lawfulness of TSM tariffs because TAPS tariffs were excessive.

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The 1996 statement of Conoco President and CEO Archie Dunham after his company traded the Milne Point field to BP lends force to this question. In an interview with *Hart's Oil and Gas Investor*, Dunham said, "It broke my heart to trade Milne Point, but we had to do it. All the value of that property was taken away from us in the pipeline tariffs."⁷ Conoco did not have an ownership interest in TAPS and was the only company other than ARCO and BP to operate a North Slope field. The real losers when Conoco left Alaska were the people of Alaska, whose State General Fund and Permanent Fund depend heavily on resources managed to maximize revenue by ensuring open competition on a level playing field.

If pipeline regulation fails, pipeline control then becomes an antitrust question. Although antitrust laws are broad, they are also vague, difficult to enforce and seldom used upstream. The Federal Trade Commission (FTC), which appears to have taken the lead for the Federal government in reviewing the recent round of oil industry mergers, typically considers the effects of a merger in terms of consumer-related issues, such as the competition in the marketing of gasoline. But even if there is no immediate, direct effect on the price at the gas pump, the Federal Trade Commission can consider the long-term anticompetitive effects of a merger.⁸

The departure of producers and potential producers from the North Slope during the 1990's strongly suggest that tariff regulation has not served to prevent anti-trust abuse by the major TAPS Owners. In dealing with TAPS tariff issues, the State of Alaska has never raised anti-trust claims. In this regard it may be relevant to note that in 1985 the Department of Law, then promoting the controversial TAPS Settlement

⁷ Leslie Haines, "Getting to the Future First" (interview with Conoco President and CEO Archie Dunham), *Hart's Oil and Gas Investor*, (reprint provided by Conoco Public Affairs Dept.). Dunham also noted that consolidation was also a factor in Conoco's departure.

⁸ The U.S. Justice Department and the FTC have concurrent authority over key provisions of federal antitrust laws and coordinate their handling of antitrust issues to avoid duplication of efforts (see: *The Big Squeeze*, pp. 3.3 - 3.5; the inter-agency working relationship is described in U.S. Department of Justice, Antitrust Division Manual, "Chapter VII: Antitrust Division Relationships with Other Agencies and with the Public," September 1, 1983, pp. VII-1 through VII-6 [first issued August 27 (1979)]).

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Agreement, agreed that it would join the TAPS Owners in defending that settlement against any legal challenge.⁹ It is not clear whether the State's 1985 TAPS Settlement Agreement prohibits the State Administration from raising this question regarding TAPS. This is an important question because the FTC would give significant weight to the State of Alaska's position regarding concerns that the departure of ARCO and the increased dominance of BP as a threat to future North Slope development.

C. The TAPS Tariff and State Revenue

The TAPS tariff allows the Carrier (Owner) to recoup costs, plus a guaranteed profit. Unlike the shipper who owns the pipeline, a Non-Owner Shipper pipeline pays all pipeline costs out of pocket. Any excess charges captured in the tariff will *increase* the profits of the Owner-Shipper while *reducing* profits of the Non-Owner-Shipper. High tariffs are the principal means by which pipeline owners discriminate against non-owner shippers; that's why pipeline tariffs are regulated.¹⁰

By virtue of its royalty interest, the State of Alaska is, in effect, a Non-Owner-Shipper on TAPS. Because severance taxes are calculated in a manner roughly similar to that of royalty calculations, pipeline tariffs also affects severance tax collections. When royalty and severance effects of pipeline tariffs are combined, every dollar included in the TAPS tariff reduces State royalty and severance tax payments by approximately \$0.23. The general relationship between State revenue and TAPS tariffs can be seen in the following simplified tables.

⁹ Sec. 1-3 of the TAPS Settlement Agreement reads: "State and TAPS Carriers shall cooperate, each at its own expense, in securing all necessary governmental approvals for this agreement and in defending against any litigation affecting the validity and enforceability of this Agreement, or any provision thereof." *Settlement Agreement between The State of Alaska and ARCO Pipe Line Co., BP Pipelines Inc., Exxon Pipeline Co., Mobil Alaska Pipeline Co., Union Alaska Pipeline Co. with Respect to the Trans Alaska Pipeline System* (submitted to FERC in Docket OR 78-1), June 28, 1985. (Although the State must defend the TSM, the State may challenge the tariffs filed under TSM if it has reason to believe those tariffs were not filed in accordance with TSM. For discussion of TAPS tariff litigation at FERC since the 1985 settlement, see *The Big Squeeze*, pp. 5.1-5.23.

¹⁰ See *The Big Squeeze*, pp. 1.1-1.5.

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Table 1.

Simplified State Royalty and Severance "Take"
(Pipeline Tariff = \$2.80) *

<u>Item #</u>	<u>Description</u>	<u>\$ per barrel</u>
(1)	Avg. ANS Price (1997)	\$18.98
(2)	Less Pipeline Tariffs	(\$2.80) *
(3)	Less Tanker	(\$1.35)
(4)	Wellhead (item 1 - [items 2 + 3])	\$14.83
(5)	∴ Royalty (item 4 * 0.125)	1.85
(6)	∴ Severance (item 4 * 0.15 * 0.875)	1.97

Adapted from: Richard A. Finchberg, *How Much Is Enough? Estimated Industry Profits from Alaska North Slope Production and Associated Pipeline Operations, 1993 - 1998* (preliminary report to Oilwatch Alaska, December 1998), "1997 ANS Profits Worksheet," p. 40.

* Pipeline tariffs include \$2.71 for TAPS and \$0.09 per barrel for North Slope "feeder" pipelines.

State production "take" from royalty and severance in the simplified example above is \$3.82 per barrel. Table 2., below, presents the results if the pipeline tariff is reduced by \$1.00 per barrel, to \$1.80.

Table 2.

Simplified State Royalty and Severance "Take"
(Hypothetical Example; Pipeline Tariffs = \$1.80)

<u>Item #</u>	<u>Description</u>	<u>\$ per barrel</u>
(1)	Avg. ANS Price (1997)	\$18.98
(2)	Less Pipeline Tariffs	(\$1.80)
(3)	Less Tanker	(\$1.35)
(4)	Wellhead (item 1 - [items 2 + 3])	\$15.83
(5)	∴ Royalty (item 4 * 0.125)	1.98
(6)	∴ Severance (item 4 * 0.15 * 0.875)	2.08

Adapted from Table 1.

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Due to the \$1.00 reduction in pipeline tariffs in this hypothetical and simplified example, the State production "take" increases by \$0.24, to \$4.06 per barrel. In other words, as a direct result of the pipeline tariff reduction, the State of Alaska an additional \$0.24 per barrel in royalty and severance payments.¹¹ The portion of the dollar reduction in pipeline tariffs that does not go to the State is divided approximately as follows:

- Producers \$0.50 per barrel
- Federal government \$0.26 per barrel.¹²

When you're dealing with more than one million barrels of oil per day, every day of the year, cents-per-barrel changes in the tariff can have significant revenue consequences. Therefore, from a fiscal standpoint (over and apart from the potential benefits of increased competition and improved environmental performance), closer look at the construction of the TAPS tariff and its effect on State revenue is therefore warranted.

D. Elements of the TAPS Tariff

The TAPS tariff is based on an annual total revenue requirement which is the sum of seven major tariff elements. Each element of the tariff is calculated in accordance with terms spelled out in the 1985 TAPS Settlement Agreement between the State and the TAPS Owners. The required revenues are charged to each barrel shipped through TAPS on a per-barrel basis. The seven elements of TSM are listed in Table 3, along with a rough estimate of the total revenue requirement and per-barrel share for each element in 1997. (The figures here are approximations; individual Carrier tariffs will differ due to factors such as the owner company's financing of capital costs.)

¹¹ The actual relationship between the State "take" and the pipeline tariff will be slightly different due to factors removed from this simplified example, such as the reduction to severance taxes by the Economic Limit Factor, or E.L.F. Typically, the state "take" increases or decreases approximately \$0.23 for every \$1.00 change in the tariff. For a more detailed description of the distribution of revenue from a barrel of North Slope crude oil, see *How Much Is Enough?*, pp. 9-26.

¹² *Ibid.*

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Table 3.

Elements of 1997 TAPS Tariff

(1.354 million bpd = 495.6 million barrels)

<u>TAPS Tariff Element</u>		<u>Total Revenue Requirement</u>	<u>Per-barrel Share</u>
<u>Item #</u>	<u>Description</u>	<u>(\$ millions)</u>	<u>(\$ / bbl.)</u>
(1)	Operating Costs	\$494.0	\$1.00
(2)	Capital Costs (Depreciation)	87.0	\$0.18
(3)	State and Local Property Tax	\$64.4	\$0.13
(4)	State and Federal Income Tax	\$272.6	\$0.55
(5)	Recovery of Deferred Return	\$99.1	\$0.20
(6)	DR&R Allowance	\$8.4	\$0.02
(7)	After-Tax Margin	<u>\$307.2</u>	<u>\$0.62</u>
(8)	Total	\$1,332.7	\$2.70

Source: Estimated from Alaska Dept. of Revenue property tax worksheets and various other sources. (See: Richard A. Finberg, *How Much Is Enough? Estimated Industry Profits from Alaska North Slope Production and Associated Pipeline Operations, 1993 - 1998* [preliminary report to Oilwatch Alaska, December 1998], "1997 ANS Profits Worksheet," p. 40.)

A brief explanation of each item collected as part of the tariff may be useful to the reader: Item #1 represents the cash Alyeska Pipeline Service Co. draws from the Owners for TAPS operations and maintenance. Item #2 is the repayment to the TAPS Owners for their investment in TAPS. Item #3 is the Oil and Gas Property Tax, which is based on the assessed value of TAPS. Item #4 is the revenue collected to pay State and Federal income taxes. Item #5 represents deferred income the owners collect in recognition of earlier capital costs. Item #6 represents the tariff amount collected for future dismantling and removal of the pipeline and restoration of the right-of-way. Item #7 is the profit element.¹³

¹³ For description of tariff elements, see: State of Alaska and United States Justice Department, *Explanatory Statement of the State of Alaska and the United States Department of Justice in Support of Settlement Offer* (Federal Energy Regulatory Commission, Docket No. OR 78-1, June 28, 1985).

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E. Are TSM Tariffs Excessive?

In a 1996 University of Wisconsin Master's Thesis, economist Antony Scott reported that the TSM tariffs exceeded reasonable, cost-based tariffs by large margins. TSM, Scott concluded, "deviates in important ways from conventional tariff methodologies."¹⁴ According to Scott, over the life of the settlement, the tariff overcharges reduce the value of oil to the producers by so much that the State of Alaska loses \$4.5 to \$9.2 billion in royalties and taxes, while the Federal tax loss is \$1.9 to \$2.7 billion. Scott's estimates were stated in inflation-adjusted 1995 dollars.¹⁵ His thesis is the most recent and most comprehensive of several challenges to TSM since the agreement was announced in 1985.¹⁶

Discussing the reasons that TSM was adopted, despite what he termed its manifest defects, Scott observed that TSM's departures from cost-based principles "appear to be concessions wrested from the State." Reviewing the history of the settlement, Scott concluded that those concessions were driven in large part by the State of Alaska's apparent fear of what he called FERC's "refusal to regulate."¹⁷

F. Effects of Excessive TAPS Tariffs

Scott's 1996 thesis lends credence to the possibility that TAPS has been used by its major Owners to restrict North Slope competition by offering a plausible explanation for the pattern of departures of major oil companies from the North Slope. By charging excessive tariffs, TAPS Carriers can reap excessive profits for their owner companies at the

¹⁴ Antony Scott, *The Trans-Alaska Pipeline System: The Causes and Consequences of Regulatory Failure* (Master of Science Thesis, University of Wisconsin-Madison, 1996), p. 12.

¹⁵ *Ibid.*, pp. 125, 131.

¹⁶ For a summary of other TSM critiques (including two by the author of this report), see *The Big Squeeze*, pp. 4.16 - 4.24.

¹⁷ *Ibid.*, pp. 28, 196. Scott also concluded that "if nothing else, this case study presents an example of how not to conduct public policy" (p. 257). "The settling parties," Scott observed, "unnecessarily clouded the picture." He pointed out several ways that the absence of clear, basic information about key aspects of TSM made analysis more difficult. For example, he concluded that "carrier returns under TSM are opaque" and that "TSM dramatically obscures what carriers earn from the pipeline" (pp. 28, 38, 262).

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expense of Non-Owner-Shippers. One possible example of this result is Conoco's departure from the North Slope. After years of unsuccessful attempts to challenge TAPS tariffs at FERC, in 1993 Conoco traded its North Slope properties to BP and left Alaska.¹⁸

G. The TAPS Tariff DR&R Provision

Apart from the possible consequences of excessive TAPS tariffs due to poor regulation, Scott's economic analysis confirms a second salient fact about the 1985 TAPS Settlement Agreement: Scott confirms that the TSM DR&R provision at Exhibit E of the Settlement Agreement¹⁹ provided an *additional* gain to the TAPS owners of extraordinary proportions.²⁰ Inaccurately portrayed as revenue-neutral by the proponents of the settlement, the DR&R provision received little attention in the belated public reviews at the time of the settlement.²¹ The staggering size of the DR&R windfall to the TAPS Owners resulting from this tariff element was not recognized until the Alaska Public Utilities Commission's Staff Expert Witness quantified the gain to the Carriers in his December 1986 analysis.²² According to Scott, "... in 1995 dollars, the carriers' DR&R 'fund' is between \$9-\$13 billion too large. The sum will grow larger still if the date when DR&R disbursements must be made is postponed" (rather than conducted between 2012 and 2015, as TSM assumed).²³ Because the TSM did not require the tariff collectors to escrow the DR&R funds, those

¹⁸ Scott, pp. 169, 252. Scott's assertion of a possible link between TAPS tariffs and Conoco's departure predated the public statement of Conoco's president and CEO noted above.

¹⁹ For DR&R terms, see: *Settlement Agreement*, Sec. 11-4 and Exhibit E; and *Explanatory Statement of the State of Alaska and the United States Department of Justice in Support of Settlement Offer*, pp. 30-31.

²⁰ Scott, pp. i, 59-68, 259-260.

²¹ For an analysis of public review of the TAPS settlement, see: Richard A. Finelberg, *The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes* (Alaska State Legislature [Supplemental Report]), Feb. 5, 1990.

²² Rudolph L. Bertsch, *Filed Testimony of R.L. Bertsch* (Staff Expert Witness testimony, in Alaska Public Utilities Commission Docket No. P-86-2, Dec. 17, 1986), pp. 63-70 and Exh. RTD-15, Schedules 1 and 2 (reprinted in Richard A. Finelberg, *Hidden Billions: The TAPS DR&R Provision* [prepared for Stan Stephens, August 1992], pp. 47-57).

²³ Scott, pp. 259-260.

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funds passed directly into the hands of the TAPS Owners. That's \$9 to \$13 billion in pure windfall profit for the TAPS Owners, with all dismantling charges paid — over and above the annual profits tallied in Item 7 of the tariff in Table 3.

Under TSM, payments to reimburse the Owners for future DR&R outlays were collected on an accelerated or "front-loaded" basis under a fixed schedule set out in Exhibit E to the 1985 Settlement Agreement. The purpose of collecting DR&R in advance of actual outlays is to match those costs with barrels shipped. While there are clear public policy reasons for allowing a pipeline owner to recoup *prior* capital investment on a hyper-accelerated depreciation schedule — to free up capital more rapidly for further development, for example — there was no apparent or logical reason to accelerate collections for *future* cash outlays. But that is exactly what the TSM did.

In 1985 it was virtually impossible to estimate the correct amounts to pre-collect for DR&R. Even if the date of pipeline shutdown could have been known with certainty, three estimating factors necessary to calculating the correct pre-collection of DR&R through the tariff were uncertain or unknown at that early date: Specifically, the collected amounts in Exhibit E of the Settlement Agreement had to include adjustments to recognize assumptions regarding (1) the return the Owners would realize from the pre-collected funds during the intervening years between collection and expenditure, as well as (2) the rate of inflation during those years. Since the DR&R collections constituted income until the funds were expended, the pre-collected funds would be taxable; the DR&R collections were therefore "grossed up" by (3) the estimated income tax. The almost inevitable errors in all three early estimates created DR&R over-collections, resulting in a windfall of enormous proportions for the TAPS Owners.²⁴

The difficulty in making DR&R estimates so far in advance of actual pay-out is most simply demonstrated by reviewing the third factor: The

²⁴ See: Bertuchi, Finchberg and Scott, *op. cit.*

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Tax Reform Act of 1986 reduced the corporate income tax from 46% to 34%; by that time, the TAPS settlement had already been approved by FERC — including DR&R collections "grossed up" to include taxes calculated at the higher rate. Even though the higher tax rate would never be paid, the TAPS Shippers for the higher rate. Because there was no provision to reduce the DR&R collection schedule in the 1985 TAPS Settlement Agreement and the funds were not escrowed, the TAPS Owners were able to keep that money.

Through 1998, TAPS Shippers paid approximately \$1,535 million in TAPS tariffs for DR&R, or 98% of the estimated total DR&R tariff stipulated as part of the TSM. The after-tax value to the TAPS Owners of the pre-collected DR&R funds at the end of 1998 has been estimated to be \$4.07 billion (Scott's low estimate), \$4.56 billion (Scott's high estimate) and \$5.90 billion (APUC Staff Expert Witness, 1986).²⁵

Part II: State Purchase, Operation and Management of TAPS

A. Introduction

The first part of this paper describes in general terms the operation of the TAPS tariff and the manner in which the operation of TAPS affects State revenue and North Slope oil development. Part II. of this paper explores three questions: (1) Could State take-over of TAPS resolve some of the problems identified in the preceding sections? (2) If so, is State take-over of TAPS is feasible? (3) What are the principal problems and policy implications associated with State take-over and operation of TAPS?

B. Fiscal Parameters of State Purchase and Operation of TAPS

In broad economic terms, three aspects of the TAPS tariff stand-out. Through the mechanisms of front-loaded (hyper-accelerated) depreciation schedule and recovery of deferred return, capital investment in TAPS

²⁵ Scott, Tables A1.4 and A1.5; Bertelini, Exhibit RJ.13-15, Sched. 2.

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appears to have been largely repaid.²⁶ In addition, through the pre-collection of DR&R, the TAPS Owners have also received the use of a cash windfall estimated by Scott at the end of 1998 to be \$4.07 to \$4.56 billion. For property tax purposes, TAPS is valued today at approximately \$3.0 billion. Based on these figures, it makes sense for the State of Alaska to consider the purchase of TAPS and take-over of DR&R liability, along with the present value of the funds the TAPS Owners have pre-collected for that purpose.

If the estimated value of the TAPS DR&R collections is placed at the midpoint of Scott's estimates (\$4.31 billion), the net result of the transaction would be a transfer to the State of Alaska of TAPS and associated aspects, plus approximately \$1.31 billion in cash. That amount could be deposited into an escrow account for future DR&R expenditure; the escrowed, publicly-held TAPS DR&R fund would be supplemented, as necessary, in amounts to be determined by modelling.

In Table 4, the right-hand column shows the effect on the 1997 TAPS tariff of the tariff reductions resulting from State take-over and operation of TAPS on a non-profit basis. Under this regime, profit and income tax elements — tariff elements (5) and (7) — would no longer need to be collected. Even with a hefty per-barrel charge to cover additional capital expenditure and contributions to the DR&R fund, the resulting tariff reduction (item [8]) would allow the State to deliver oil to Valdez at a tariff well below that currently charged by the TAPS Owners, enhancing the competitiveness of North Slope oil while increasing State royalty and severance returns.

²⁶ More research in this area is needed. In the few available public accountings of TAPS tariff elements, the distinction between capital funds that repay original investment and those earmarked to cover subsequent capital investments in TAPS is not always clear. When these distinctions are clarified so that the resulting elements can be modelled to assure appropriate capital repayment on investment, the likely net effect will be to reduce the tariff significantly (see Table 4, below).

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Table 4.

Revised Elements of TAPS Tariff

(Based on 1997 tariff; see Table 3, above)

<u>TAPS Tariff Element</u>		<u>1997</u> <u>Per-barrel</u> <u>Share</u> <u>(\$ / bbl.)</u>	<u>State-Owned</u> <u>Per-barrel</u> <u>Share</u> <u>(\$ / bbl.)</u>
<u>Item #</u>	<u>Description</u>		
(1)	Operating Costs	\$1.00	\$1.00
(2)	Capital Costs (Depreciation)	\$0.18	\$0.18 **
(3)	State and Local Property Tax	\$0.13	\$0.13 *
(4)	State and Federal Income Tax	\$0.55	
(5)	Recovery of Deferred Return	\$0.20	\$0.20 **
(6)	DR&R / New Capital DR&R	\$0.02	\$0.49 ***
(7)	After-Tax Margin	<u>\$0.62</u>	—
(8)	1997 v. State-Owned Tariff	\$2.70	\$2.00

Notes:

1997: See Table 3, above.

* Under a State-owned pipeline, it might be possible to guarantee this amount for an extended period; this would relieve the pipeline boroughs of fighting annually to secure appropriate valuation of TAPS for property tax purposes.

** These elements reflect minimum estimated tariff reductions; more detailed analysis and long-term modeling should result in further tariff reductions.

*** This element is set artificially high to cover future capital and DR&R amounts.

While modelling of fiscal effects of State operation of TAPS is beyond the scope of this analysis, it is possible to get a sense of the consequences of this proposal by making adjustments to the model presented in the author's 1998 report on TAPS profitability. For purposes of this analysis, the TAPS tariff elements in that report were altered for 1997 and 1998 calendar year operations by reducing the TAPS tariff to \$2.00 per barrel for each year through the tariff adjustments discussed in the preceding section. The tariff reductions resulting from State operation of TAPS increased State revenue in 1997 and 1998 by a minimum of \$85 million per year.²⁷

²⁷ This is a minimum estimate. Further research and modelling of the TAPS capital structure is likely to result in further tariff reductions. (See preceding footnote.)

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D. State Management of TAPS

Even if the concept of State management of TAPS is attractive from a fiscal perspective, there are other policy questions to consider. Three important questions regarding State management of TAPS concern (1) effective management, (2) the related question of cost control and (3) environmental policy.

To operate TAPS, the State might set up a quasi-public corporation along the lines of the Alaska Railroad Corporation. In this case, the Board of Directors would be analogous to the TAPS Owners' Committee. The Alyeska Pipeline Service Co., which operates TAPS as the agent for the TAPS Owners, might be retained as the operating agent for a new State pipeline corporation.

Cost control, already a problem for the TAPS Owners, could become an even greater problem under State ownership. However, pipeline managers could use the same techniques to promote cost savings that Alyeska now uses. At present, Alyeska managers remind employees that the success of future North Slope development depends on holding transportation costs down so that Alaskan oil can compete on the global market and employees receive year-end bonuses for cost-savings and safety. Public managers could continue to make effective use of both techniques.

From an environmental standpoint, there are two apparent benefits of State take-over and management of TAPS: (1) In day-to-day operations, under public ownership the TAPS operators would be under less pressure to cut corners because they would no longer be hammered by the cost-cutting demands of shareholder-conscious executives on the TAPS Owners Committee. (2) As TAPS shutdown nears (at some point in the future), the State is liable to face this dilemma: The North Slope producers may determine that the need to commit funds for DR&R (previously collected but not escrowed) will deprive those companies of capital that might otherwise be used to extend temporarily the life of the North Slope. In this situation, the State may be sorely tempted to back down environmental

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requirements to restore the pipeline right-of-way to pre-construction condition.

E. Putting It All Together: Four Critical Questions Regarding the Proposed Merger and State Take-Over of TAPS

By increasing control of TAPS to 72% (where key decisions of the TAPS Owners Committee require a 70% majority), the proposed ARCO-BP merger invites consideration of the question of monopoly control of TAPS. More broadly, is the possibility that control of TAPS by its major Owners has stifled open competition on the North Slope a significant public policy concern? Implicit in the 1996 endorsement of competition by the Governor's Oil and Gas Policy Council is the belief that open competition enhances the State's public policy goals by allowing companies with different investment strategies, different technical strengths and different environmental attitudes to enter the North Slope market. Following this line of reasoning, the first question is:

- 1. What constitutes sufficient proof, for public policy purposes, that the major Owners of TAPS have used (and/or will use) the pipeline to inhibit competition?

If policy makers believe that TAPS has been used to stifle competition to a significant degree, the next question would be:

- 2. Are there legal remedies?

It should be noted that sufficient proof for a policy maker that TAPS has functioned to inhibit competition might not be sufficient proof to prevail in court. Putting legal imponderables aside for the moment, consideration of the possibility that TAPS will function to inhibit competition leads to the following questions:

- 3. Should the North Slope producers be required to sell
 - a. All of TAPS?
 - OR
 - b. A portion of TAPS?

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The body of studies arguing that TAPS tariffs under TSM are excessive combine with the departure of Non-Owners from the North Slope to provide strong indication that TAPS has functioned to inhibit competition. To the extent that the concerns discussed in this briefing paper are based on a pattern of past behavior, it follows that requiring ARCO-BP to divest ARCO's share of TAPS (22%) will merely perpetuate — rather than correct — the unhealthy situation that has led to BP's domination of North Slope development.

- 4. Should the prospective buyer be:
 - a. An independent pipeline company?
 - OR
 - b. The State (perhaps acting through a quasi-independent commission or authority)?

From a fiscal perspective, there are two reasons to favor a State take-over. First, the preliminary analysis presented here suggests that the State can operate TAPS at a significantly lower tariff than a private corporation. Additionally, despite its guaranteed profit on TAPS, an independent company might be reluctant to buy TAPS because that company would be acquiring the TAPS DR&R liability without the funds to perform that obligation (98% of the DR&R money has already been collected, but the funds were not escrowed).²⁸

F. The State's Role in TAPS Divestiture Issues

With both the TAPS right-of-way agreement and the tariff agreement itself coming up for review during the next decade, the State of Alaska might have leverage to redress problems associated with monopoly control of TAPS, as well as certain inequities in the TAPS tariff structure, such as DR&R. As indicated above, however, the State (or at least the Administration) may have some difficulty approaching this question due to its agreement to defend the 1985 TAPS tariff agreement against any

²⁸ In 1992 an investment analyst told the author he had recommended that an investor not buy North Slope production interest because DR&R liability issues on the North Slope had yet to be decided. In the case of TAPS, the problem would be magnified.

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litigation. If the State Administration now finds its hands tied by the language of its 1985 agreement to the TSM, concerned citizens and policy makers might want to devise a strategy that would provide some measure of State support for an antitrust challenge to the conduct of the TAPS Owners in implementing TSM. In this event, it might be useful to consider the following questions:

- The State Administration has been in litigation since 1985 challenging aspects of the implementation of TSM.²⁹ Can the antitrust effects of TAPS the implementation of TSM be challenged without violating Section 1-3 of the TAPS Settlement Agreement?
- If the State Administration must defend TSM under its 1985 agreement, does the language of that settlement prevent the Alaska State Legislature from challenging provisions of the agreement?
- If the State Administration must defend TSM under its 1985 agreement, does the language of that settlement the Alaska Permanent Fund from challenging provisions of the agreement?
- If the State Administration must defend TSM under its 1985 agreement, does the language of that settlement prevent the Alaska State Legislature from creating an independent authority that can challenge TSM provisions?
- FERC approved the TAPS settlement in part on the basis of estimates regarding financing of TAPS dismantling, removal and restoration (DR&R) that were impossible to make at that time or arguably false; can this fact be used to nullify the TSM (including the requirement that the State of Alaska defend TSM)?

While it is not possible to answer this line of questions definitively without additional legal analysis, it may be useful to consider them in the public dialogue concerning the State of Alaska's public policy options with regard to the proposed ARCO-BP merger.

²⁹ For summary of tariff cases litigated at FERC, see *The Big Squeeze*; see also correspondence between the Alaska Attorney General, the author and Oilwatch Alaska, October-November 1997, various dates.

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IV. Conclusion: Why Should the State of Alaska Buy TAPS?

Purchase of TAPS under terms similar to those outlined in this report would give the State of Alaska the ability to accomplish the following major policy objectives — without cash outlay:

- deliver oil to Valdez at tariff rates below those charged by the TAPS Owners under TSM, thereby (1) enhancing the competitiveness of North Slope oil in the world market and (2) increasing annual oil revenue receipts severance tax and royalty receipts;
- manage TAPS to ensure competition;
- ensure that the pipeline communities receive a stable (rather than a declining) revenue stream in lieu of property taxes;
- ensure that cost-cutting does not affect environmental performance (a current and chronic problem on TAPS); and
- escrow DR&R collections, reducing the inevitable pressure on the State, created by the present DR&R arrangement, to trade performance of DR&R obligations for latter-day investment that would prolong North Slope production.

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4/15/99

Jerry McCutcheon Testimony 4/15/99

You can kiss the Gasline good bye. It will not fly. That is the last good thing I will have to say about the merger. I have fought the gasline for almost 25 years.

The BP / ARCO merger will result in a colossal screwing of Alaskans. It is BP's corporate responsibility to screw Alaska legally or ILLEGALLY. The shotgun wedding of Amoco and BP moved BP up into the class with Royal Dutch Shell and EXXON. Both Shell and Exxon have lost interest in Alaska and withdrawn from Alaska because Alaska has matured as an oil province and no longer fits its' financial recourses and political power of EXXON and Shell. EXXON is maintaining minimal personnel in Alaska ; just enough to keep ARCO honest in overseeing ARCO's production of the EXXON / ARCO leases. Alaska has been BP's cash cow which allowed BP to swallow up Amoco and others. Now ARCO!

ARCO is a company which not only fit's Alaska, although a tight fit, but more importantly a company which needs Alaska's oil for ARCO's west Coast refineries both today and tomorrow. ARCO used Alaska as a cash cow to further ARCO world dreams, but ARCO ,with only half Alaska's oil that BP has, not only got into trouble on the world stage but also lost ARCO's ability to handle small prospects. ARCO forgot it origins, in ARCO's heady flow of cash from its cash cow, Alaska.

ARCO was weathering the storms of ARCO's indiscretions, ARCO learned its' lessons and ARCO would have survived nicely but the prolonged depression of the price of oil was more than it apparently wanted to withstand.

The State of Alaska should buy ARCO . ARCO is almost a perfect fit with Alaska's need for an oil company large enough to undertake any of Alaska projects and small enough to pursue Alaska's smaller prospects, but not its' smallest prospects.

The ARCO sale is not yet a done deal; if it were we would not be here today. Again the State of Alaska should buy ARCO. ARCO is a company that has learned its' lessons, but apparently too late to save itself and be the forceful company ARCO's current board directors believe ARCO should be. Alaska does not have to manage ARCO like the Alaska Railroad and the Alaska Ferry System. Alaska's ownership should be that of a large shareholder; and it may probably be best if Alaska did not own all of ARCO.

It is far better to own ARCO, a very profitable oil company that is currently strapped for cash, than become an owner in "The Gasline" who's prospects for profitability are so bleak that the owners of the gas do not want to construct the gasline; even with the State giving up the State's royalty gas and severance taxes; forcing the Cities along the proposed pipeline route to forgo their taxes which the Cities will need to pay for the increased cost of government due to the construction of the gas pipeline.

Cash for an ARCO acquisition has never been cheaper. Buying ARCO is not a difficult acquisition to structure; it is a far simpler than the unprofitable gasline that all of you have been thrashing around trying to force into being.

A legislator who wants to buy into a gasline, with bleak, at best, prospects for profitability, and yet does not want to buy a very profitable oil company is called many things, among them a sociopathic hypocrite in need of a Psychiatrist.

BP, with the acquisition of Amoco, joins EXXON and Shell in seeking their fortunes where only BP's new found and financial recourses and political power can exploit. BP will leave Alaska; not like Shell who has almost sold out nor like EXXON who has minimal staff to oversee the residual of EXXON's asset, but more slowly. BP will milk BP's cash cow for all it is worth, they will milk Alaska so hard BP will kill it both figuratively and literally. BP will plot and time the final collapse of BP cash cow with BP's departure.

BP will use a Decision Tree and Monty Carlo analysis to exploit Alaska just like it does any other prospect. BP will batter and batter Alaska. When one partner knows a divorce is coming, they tell the other party everything they want to hear while they chip away elsewhere and exploit what is left of the relationship until it finally collapses.

BP will not only be a worse "alleged partner" for it is their corporate responsibility to exploit Alaska but also BP will have a parade of shills seducing Alaskans into believing BP is really looking after Alaska's best interests. It will be like the last days of the canned salmon industry, only much worse. The cost of buying Alaska's political offices, press and judiciary does not even rise to the level of BP's pocket change.

BP's oil pipeline screwing of Alaska, cost Alaska \$5 billion by 1987 and will cost Alaska \$40 billion by 2010.

BP et al gut and run almost wrecked Prudhoe Bay oil recovery excepted they got caught. Recovery would have dropped to 5 billion barrels.

BP did wreck Badami. I do not know the roll BP played in Lisborn.

BP put on a "staged" construction of North Star modules, which they never intended to complete, to fool the public and was very successful at it with help of the press and a phony baloney law suit.

BP lied Alaskans about the producibility of Prudhoe Bay, BP told Alaskans Prudhoe would produce 9.6 billion with or without a gasline but told congress 15 billion without a gasline. Public Document 95-73 page 570. With cooperation of the press and the legislature BP continues to fool the only too willing public. That producibility had risen to 17 billion barrels before 1989, with 1970's technology. And if the current roomers are correct the prduceibility is now 20 billion.

At the request of this committee, I am providing the oil and gas contractor community's perspective on the BP Amoco - ARCO merger. I will not comment on royalties and taxes. We believe these issues are best addressed by the state. I will talk about the concerns that the support industry has with regard to the competitive downsizing to one major operator/producer and what that means in terms of contracts and jobs.

The Alliance does not have an opinion on the specifics of the merger. Not all of the details are available, nor is information on the potential impacts. We believe it is prudent to gather the facts. We applaud the governor's initiative to form a team to gather critical information regarding impacts to Alaskan hire and Alaskan buy, investor competition, environmental protection, and state revenues.

Our Concerns

The Alliance does not view the proposed merger as a crisis. We do, however, recognize it as a profound turning point, changing the landscape of Alaska's oil and gas industry.

The idea of one main operator on the North Slope is not new. For years the industry has taken measures to reduce costs, and having one operator is the next logical step toward further efficiency. The biggest surprise that came with the merger announcement is that it would leave the state with not only one *operator*, but also one main *producer* on the North Slope. We are also waiting to hear what the merger would mean to operations in Cook Inlet since BP does not currently have a presence in this area.

Alliance members are also concerned that the number of support industry contracts will shrink with the advent of one major operator. Initially, we expect to see further job losses in the support sector as administrative functions are consolidated.

Support industry businesses will likely respond to demand changes by streamlining their own operations, and perhaps negotiating their own mergers and consolidations.

Competition is critical to successful leasing programs in the National Petroleum Reserve-Alaska, the Outer Continental Shelf and possibilities in ANWR. We agree with the Governor that it is time to aggressively market Alaska. We must effectively promote the state's resources and strengths. And we must address the state's weaknesses. The biggest weakness, of course, is the image of instability that our \$1.2 billion fiscal gap causes. Closing the gap remains our top priority. We cannot stress enough the importance of closing the fiscal gap this year.

Long Term Optimism

While The Alliance does have questions over the merger, we also believe there is room for optimism in the long term.

If the merger makes the resulting company more competitive under increasingly difficult business conditions ... as BP and ARCO say it will ... than The Alliance believes this bodes well for Alaska's future in petroleum development. Weakened companies simply cannot afford to operate in remote, expensive locations like the North Slope, especially when oil prices are low.

As BP Amoco and ARCO consolidate their operations, they will undoubtedly realize efficiencies. Money freed up from cost savings may well be spent on exploration and production activity, which would mean jobs and contracts for support industry businesses.

We also believe that BP Amoco will make full use of the assets it acquires from ARCO. A company would not sensibly spend \$26 billion to acquire facilities, land and assets and then allow them to sit idle. BP Amoco's commitment to spend \$5 billion on North Slope development over the next five years indicates that Alaska's potential is viewed as long-term.

The Alliance is encouraged by a number of other commitments that BP Amoco has made, both to the public and in direct conversations with Alliance members. We believe these commitments will eventually equate to dollars for the state and work for the support sector.

BP Amoco has said it will pursue ways to commercialize Alaska's vast natural gas reserves. We welcome the pledge to continue the ARCO's natural gas sponsor group. And are encouraged by initial plans to fund a gas-to-liquids plant on the North Slope. This project will give contractors an opportunity to use the skills, tools and facilities that came with the advent of module fabrication in Alaska. Without such projects, this new module industry would fade.

As for the issue of the merger's impact to environmental protection, The Alliance is confident that the industry will continue to excel. Even the Clinton Administration has said that we're exploring, developing and producing resources the right way in Alaska. BP has long been a player in Alaska's model operations. Worldwide, BP's corporate philosophy is focused on development that does not compromise environmental protection or employee safety. As contractors, we have been witness to, and players in, upholding this commitment.

The Status Quo Won't work

The oil and gas industry has proven its resiliency over many years, surviving lean times with ingenuity and sound decisions. Together, producers and support businesses have lowered production costs through advanced technologies. We've lowered operational costs by eliminating redundant services. We've consolidated resources and assets to remain competitive. Had the industry maintained the status quo, it would have failed. We see the merger as a business decision that is responding to a changing global environment

The status quo will not work now to the benefit of Alaska's oil and gas industry. Nor will "business as usual" in state government work to the benefit of Alaska's people.

The Alliance appreciates the opportunity to voice our early opinion on this potential merger and the effects it may have on our industry. As additional information comes forward, we'll be better prepared to address specific impacts in our industry.