HB

277

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Testimony before the House Oil & Gas Committee
on H.B. 277
Richard A. Fineberg, P.O. Box 416, Ester, Alaska 99725
April 22, 2003

Thank you for the opportunity to testify on H.B. 277. I believe this proposal to further emasculate the Regulatory Commission of Alaska (RCA) has enormous potential to do harm on two fronts. First, this bill strikes a sharp blow against the healthy competitive environment that is essential to continued oil development in this state by eviscerating the commission's authority to deal constructively with pipeline tariffs in a variety of significant ways. At the same time, this bill adversely affects the State Treasury by preventing the commission from promoting just and reasonable pipeline tariffs.

This is special interest legislation, pure and simple. The special interest is that of the three major owners of the Trans-Alaska Pipeline System (TAPS), who own more than 90 percent of TAPS and a similar percentage of the North Slope production that they ship through the pipeline they control. Over the last three decades I have observed the harmful economic and environmental effects of this unhealthy synergy from a variety of perspectives -- as a reporter during pipeline construction (1974-1978), as a senior advisor to the Governor on oil and gas policy (1987-1989) again as a reporter (1989-90) and as a consultant (1990 – present). Between June 2000 and May 2001, I served as the Staff Expert Witness for the Public Advocacy Section of the RCA in the first phase of its TAPS rate case, which I will discuss below. Based on this experience, I believe the RCA, its decision in the TAPS case and its continued efforts are the targets of the carefully aimed bullets fired by HB 277, to the detriment of the public interest.[1]

Pipeline tariff issues require focused and careful analysis. That function is performed by the RCA under the Alaska Pipeline Act (AS 42.06). On November 27, 2002, the RCA issued a thorough and well-crafted order on Trans-Alaska Pipeline System (TAPS) tariffs.[2] That order authoritatively documents the enormous profitability

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[1] My most recent assessment of the enormous profits the TAPS Owners realize from the tariffs filed under TSM – along with a conservative reckoning of the separate benefits secured through the dismantling provision -- can be found in *The Emperor's New Hose: How Big Oil Gets Rich Gambling on Alaska's Environment* (Alaska Forum for Environmental Responsibility, June 2002). Chapter 5 (on line at www.alaskaforum.org).

[2] Regulatory Commission of Alaska, *Order Rejecting 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings; and Outlining Phase II Issues*, Docket P-97-4, Order #151 Nov. 27, 2002 (on-line at *www.state.ak.us/rca*). The order held that TAPS tariffs between 1997 and 2000 were 57% above the "just and reasonable" levels mandated by AS 42.06 and that between 1977 and 1996 the same tariff methodology, applied linewide, resulted in tariffs that exceeded just and reasonable levels by $9.9 billion. Although the 1977-96 tariffs were not at issue in the RCA hearing, historical tariffs had to be calculated to determine the correct tariffs for the years at issue. These central conclusions have two significant effects:

of TAPS under the 1985 TAPS Settlement Methodology (TSM). I think it is fair characterize this order as historical in its significance. Three indications of this order's importance to the state are:

➔ (1) The statement of the Department of Natural Resources Division of Oil and Gas that "[e]xcessive tariffs create barrier to entry for all oil and gas companies not owning an interest in TAPS;"[3]

➔ (2) The listing of lower TAPS tariffs by 17 key industry participants and observers as the top priority for 2003 (with streamlined permitting) and "one of the most important incentives the state could offer;"[4] and

➔ (3) The Alaska Permanent Fund Board of Trustees decision to investigate "all maintenance and operational practices, including tariff and facility pricing," that could limit development of state oil leases.[5] Each of these statements referenced RCA's November 27, 2002 order.

The Department of Natural Resources has estimated that reduced tariffs on TAPS – if applied line-wide – would increase state revenues by $110 million per year. At present, the TAPS Owners are pocketing that excessive revenue.[6] Although RCA tariffs govern only eight percent of oil shipped through TAPS (the portion going to in-state refineries), the RCA order indirectly calls into question the interstate tariffs governed by the Federal Energy Regulatory Commission (FERC) for two reasons: (1) FERC approved a virtually identical, ad hoc formula settlement in 1985; and (2) as the RCA put it, the commission order marks "the first time in more than 20 years of TAPS operations that a regulatory agency has reviewed TAPS rates for consistency with statutory standards."[7] Clearly, the RCA decision – 168 pages in length, with approximately 300 pages of endnotes and worksheets – renders the 1985 settlement more vulnerable to challenge at FERC. Perhaps this is one reason the TAPS Owners have filed every

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(1) Because transportation charges are subtracted from the market price to determine the basis for assessing royalty and severance taxes, the state loses approximately $0.21 to $0.23 for every dollar increase in the TAPS tariff (and vice-versa). By this reckoning, between 1977 and 1996 the overcharges allowed under the TAPS settlement methodology (TSM) cost the state $2.1 to $2.5 billion in revenue.

(2) Because an independent shipper pays TAPS tariffs out of pocket while a producer-shipper pays an affiliated company, excessive tariffs (plus the allowable profit on all charges) amount to a transfer payment rather than an out-of-pocket cost; benefits to TAPS owners are further compounded by tax treatment.

[3] Alaska Division of Oil and Gas, "Gas Line: Examples of the Cost of 'Fiscal Certainty'," Dec. 9, 2002 (briefing slide).

[4] "'Good news' wanted in 2003," *Petroleum News Alaska*, Jan. 19, 2003, p. 1.

[5] Sean Cockerham, "Oil lease probe sought – Permanent Fund: Corporation worries smaller companies are shut out, state is being shortchanged," *Anchorage Daily News*, Feb. 20, 2003 (on-line).

[6] Allen Baker, "State weighs pipeline fees -- $110 Million: If rates are cut, Alaskans, small producers benefit," *Anchorage Daily News*, Dec. 31, 2002, p. A-1.

[7] Regulatory Commission of Alaska, "The Regulatory Commission of Alaska Rejects Rates for the 1997-2000 Intrastate Trans-Alaska Pipeline System, Sets Just and Reasonable Rates, and Requires Refunds and Filings by Carriers," Nov. 27, 2002 (press release; on-line).

inaginable legal challenge to the initial decision – both at the RCA and in court – in an effort to preserve their ill-gotten gains. Not surprisingly, their lobbyists have now shown up on your doorstep.

By way of background, it should be noted that the TSM was negotiated between the state, represented by the Department of Law, and the TAPS Owners.[8] In the years since the settlement, the Department of Law has steadfastly defended the settlement, relying on the agreement's "duty to defend" clause[9] to argue on behalf of the gains to the TAPS Owners conferred by defects in the complicated methodology and post-settlement changes in conditions.

The direct benefits of identifying and reducing excessive TAPS tariffs are quantified and defended in the RCA decision. But that decision also deferred – and served notice that the commission intends to deal with – another matter of enormous public concern and special interest to the TAPS Owners: The tariff provisions governing TAPS dismantling, removal and restoration (DR&R) were reserved for a "Phase II" proceeding. Recently, the RCA determined that the commission had broad jurisdiction over DR&R under state law, and that it would continue the proceeding to hear that issue.[10] The industry's accelerated or front-loaded collection and retention of approximately $1.6 billion in funds for the future dismantling of the pipeline is an undeserved windfall to the TAPS Owners of enormous proportions. The 1985 settlement delivered this windfall to the TAPS Owners at shipper and public expense. The financial benefits to the TAPS Owners and the policy consequences for the state were first quantified in 1986 by the Staff Expert Witness for the Alaska Public Utilities Commission, predecessor to the RCA.[11] Since then, DR&R problems have come to public attention at least four times; in every instance, the state administration has failed to remedy the problem, thereby continuing to penalize the state treasury and place the environment at potential risk.[12]

While the DR&R provision has major implications for public policy, a relatively minor aspect of the TAPS DR&R terms may provide the best illustration of the complicated nature of pipeline tariff issues -- and the potential for TAPS owners to profit from that complexity at state expense. TSM allows the TAPS owners to collect from

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[8] *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,* June 28, 1985 (Federal Energy Regulatory Commission Docket OR 78-1), p. 1.

[9] *Settlement,* Section I-3.

[10] Regulatory Commission of Alaska, *Order Denying Indicated TAPS Carriers' Motion to Cancel Prehearing Conference and Ruling on DR&R Question,* Docket P-97-4, Order #157, March 6, 2003 (on-line at *www.state.ak.us/rca*).

[11] *Prefiled Testimony of Rudolph L. Bertschi* (Alaska Public Utilities Commission Docket No. P-86-2), December 17, 1986, pp. 63-70.

[12] For a summary of DR&R issues in the context of the TAPS tariff, see Richard A. Fineberg, *The Emperor's New Hose: How Big Oil Gets Rich Gambling with Alaska's Environment* (Alaska Forum for Environmental Responsibility, June 2002, Chapter 5 (on-line at *www.alaskaforum.org*).

shippers an income tax surcharge on all DR&R payments as part of the tariff. But instead of actually making those payments to the Internal Revenue Service (IRS), it is a matter of public record that the pipeline owners obtained a special ruling allowing annual deductions on DR&R income -- long before that money is actually spent on dismantling. For the TAPS owner shipping its own oil, the unnecessary income tax collection is simply a transfer to from the company's production arm to its transportation subsidiary. But that phantom transportation cost penalizes non-owner shippers and reduces the production arm's royalty and severance tax basis, saving the company – and costing the state -- an estimated $0.21 to $0.25 per dollar.[13] Two final notes on this subject: (1) In 2000 your colleagues tried – without success – to find out how much the state has lost over the years as a result of this scam.[14] (2) As mentioned above, this is only one of the several defects in the DR&R component of TSM – and by no means the most important.

The immediate, short-term fiscal consequences of the TAPS DR&R loophole described in the preceding paragraph are small compared to the long-term policy implications. One of the most egregious parts of HB 277 is the proposed statutory requirement that RCA support of rate methodologies agreed to in settlement agreements with the State. Over the years, the RCA and its predecessors have supported the use of a standard utility rate-making methodology for pipelines to ensure just and reasonable tariffs that promote robust competition. In my estimation, it would be an act of short-sighted blindness to overturn this important precedent. Note in this regard that TSM which HB 277 seeks to defend, is a complicated, hybrid methodology. Although you can make a case for negotiating complicated departures from standard methodology, from a policy standpoint there is much to be said for the clarity of a straight-forward approach. The income tax example discussed in the preceding paragraph provides an illustration of why hybrid settlements are so difficult to apprehend and track; the RCA's order on TAPS demonstrates the enormous fiscal implications of this particular hybrid settlement concoction.

As mentioned above, I participated in the RCA hearing on TAPS on which the commission's November 2002 TAPS order was based. For five weeks, the commissioners, the attorneys for the shippers and the commission's Public Advocacy Section spent much of their time trying to penetrate the smoke screen erected by the industry, with the state's help, in defense of its hybrid methodology. Had the fiscal and public policy consequences not been so great, this magic lantern show would have been hilarious.

In conclusion I would note that Executive Order 111 has already begun to dilute commission authority by weakening the link between the public and the RCA. The executive order states that the purpose is to assure "efficient administration" by avoiding "possible duplication of effort or the taking of inconsistent positions by separate agencies

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[13] Richard A. Fineberg, "New filings reveal oil pipeline owners' tax scam," *Anchorage Daily News*, Feb. 8, 2000, p. B-8.

[14] See: Alaska State House House Oil and Gas Committee hearing, April 13, 2001 and letter from Michael A. Barnhill, Assistant Attorney General, to Rep. Jim Whitaker, May 23, 2000.

of state government."[15] Our government depends on checks and balances; when did consistency with other state policies become the purposes of a quasi-judicial regulatory agency? I am also concerned that the transfer of the Public Advocacy Section to the Attorney General's Office further separates that unit from the public it was created to represent. The importance of public involvement in the regulatory process was brought home last month, when FERC finally issued its report on energy price gouging California – two years after the crisis, long after Enron's collapse and only after insistent prodding from Congress and the General Accounting Office.[16]

The fiscal and broader policy issues served by the RCA's efforts are summarized in the a January 3, 2003 *Anchorage Daily News* "compass" by Walter B. Parker, which I am submitting with this testimony. Historically, almost everybody who has looked seriously and independently at this complicated issue has concluded that the 1985 TAPS tariff settlement undermines competition by ratifying exorbitant tariffs that do not satisfy the statutory requirements of just and reasonable tariffs. I do not argue that the commission or its Public Advocacy Section are models of efficiency. That's not the point. In the case of pipeline tariffs, the RCA has done a masterful job of protecting the public interest in an area of great importance to Alaska's continued development. To the extent that the RCA's ability to function as an independent regulator is emasculated, the agency will not be able to implement that order or do justice to any tariff issue – including DR&R. For these reasons, I am particularly troubled by measures such as HB 277 that dilute the authority of the commission, whose links to the public it represents have already been weakened by Executive Order 111.

Thank you for your kind attention.

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[15] Executive Order No. 111, March 5, 2003.

[16] See: Edward Iwata, "Panel: FERC dropped ball on Enron," *USA Today*, Nov. 11, 2002 (on-line) and Mark Sherman (Associated Press), "FERC Finds Widespread Power Manipulation in California," *Washington Post*, March 26, 2003 (on-line).

Attachment 1.

Author's Sectional Analysis of H.B. 277 (23-LS0980\D):

Section 1 amends a key enabling section of the Alaska Pipeline Act, which enumerates the duties of the commission regarding pipelines, to curtails the authority of the state pipeline commission to regulate the abandonment of pipeline facilities. This section also removes from the commission the authority to investigate performance and compliance with lease terms *(AS 42.06.140[a])*.

Section 2 creates a new subsection that specifically denies the commission jurisdiction over dismantlement, removal and restoration of any part of a pipeline facility *(AS 42.06.250[c])*.

Section 3 further curtails the commission's authority in the complex arena where state and federal jurisdictions overlap. Where the framers of the Alaska Pipeline Act sought to ensure that the state commission would have broad powers to investigate pipeline tariff issues "except to the extent they are preempted by federal law," this legislation would deny the commission authority to "consider revenue collected on interstate transportation when evaluating intrastate rates or tariffs" *(AS 42.06.245)*.

Section 4 further limits commission authority regarding abandonment by specifying that the required commission finding, prior to abandonment, that continued service is not required by public convenience and necessity applies only to service and not to "any portion of a pipeline" *(AS 42.06.290[a])*.

Section 5 establishes a new subsection saying that any pipeline settlement with the state is considered to be in the public interest and conclusively just, reasonable and nondiscriminatory and therefore beyond the purview of the commission unless the state brings a protest or petition that a particular rate does not conform to the settlement terms *(AS 42.06.370[d])*.

Section 6 changes the interest rates on refund payments so that the rates under AS 9.30.070(a) replace the rates under AS 45.45.010(a) *(AS 42.06.400[b])*.

Section 7 specifies that any commission orders regarding rates must be limited to future tariffs and may not be retroactive *(AS 42.0.410[a])*.

Sections 8 through 11 ensure that this act applies to any matters pending before the Regulatory Commission of Alaska on the effective date, that the refund provisions of Section 6 are retroactive to August 7, 1997 and that Section 5 is contingent on Executive Order 111 taking effect.

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"Lower pipeline tariffs deserve look"

By Walter B. Parker

"Compass"

***Anchorage Daily News*, January 3, p. B-4**

Alaskans pay a high price today for a bad deal the Alaska Department of Law struck with the owners of the Trans-Alaska Pipeline System (TAPS) in 1985. That is the clear and unmistakable message of the monumental order on TAPS tariffs issued by the Regulatory Commission of Alaska (RCA) Nov. 27.

According to that decision, in recent years the 1985 TAPS Settlement Agreement has resulted in average TAPS tariffs that were 57% too high. Perhaps even more significantly, the Commission calculated that the 1985 agreement enabled TAPS owners to charge $9.9 billion over just and reasonable costs between 1977 and 1996.

As a general rule, lower TAPS tariffs mean higher state revenues. If the RCA tariffs governed, the state would have at least $2.5 billion more for schools, roads and other public purposes.

Unfortunately, the RCA order sets TAPS tariffs only for in-state oil shipped between 1997 and 2000; earlier years were not on the table and Federal Energy Regulatory Commission (FERC) governs rates for more than 90% of TAPS oil.

Other factors complicate the situation. The 1985 settlement allows TAPS owners to offset reductions in intra-state tariffs by increasing inter-state rates. Moreover, separate contractual agreements and regulations use the inter-state rate to calculate royalty and severance on the intra-state oil shipments.

According to the RCA, these factors could result in short-term state revenue losses of less than $10 million per year. But to take that revenue from the state, the TAPS owners would have to petition FERC to increase the same tariffs that RCA found unjust and unreasonable in a 486-page decision that RCA calls "the first time in more

than twenty years . . . that a regulatory agency has reviewed TAPS rates for consistency and statutory standards."

Uncertainty about small, short-term revenue effects should not obscure the following fundamental and long-term public policy truths:

- Lower pipeline tariffs encourage development by reducing total transportation costs;
- Lower pipeline tariffs increase state revenues because transportation costs are subtracted from the price of a barrel of oil before royalty and severance taxes are calculated.

In view of these important considerations, the context of the RCA case deserves further consideration. Historically, the commission and its predecessors favored the widely accepted depreciated operating cost methodology permitting pipeline operators to charge tariffs sufficient to cover repayment of investment, operating costs, taxes and a fair rate of return on investment. Instead of following this standard to determine TAPS tariffs, in 1985 state lawyers agreed to an unconventional TAPS methodology in an effort to end eight years of litigation. The RCA approved the settlement provisionally but left the door open for future protests.

In 1997 Tesoro, then refining oil shipped through TAPS, filed a tariff protest later joined by Williams Alaska, which operates the North Pole refinery, and the RCA Public Advocacy Section. All three parties argued that excessive TAPS tariffs violated the terms of the Alaska Pipeline Act, whose purpose is to insure access to common-carrier pipelines at just and reasonable rates

To deal with legal maneuvering and intense wrangling over document production covering a complicated history, the RCA issued more than 100 procedural orders, listened to five weeks of testimony, reviewed expert reports and sifted through the voluminous record before calculating appropriate tariffs.

The RCA was clearly unimpressed with the defense of the settlement rates presented by the TAPS owners and the state. Rejecting the case presented by the TAPS owners and the state, the commission ordered the TAPS owners to reduce in-state tariffs

for 1997-2000 by an average of approximately $1.00 per barrel. Presumably, orders reducing 2001 and 2002 in-state TAPS rates will follow.

Don't expect the TAPS owners, who have spent nearly $15 million on this case, to give up their ill-gotten gains without a fight; court appeals are likely.

Looking forward, just and reasonable TAPS tariffs will have a far more salutary effect on state revenue and future oil development than almost anything else the state might do. The RCA decision presents the state with a unique opportunity to correct its previous, misguided course.

Walter B. Parker of Anchorage has been active in state transportation and resource development issues for 56 years. He has served as Commissioner of Highways, Director of Technical Staff for the State Pipeline Coordinators Office and Chair of the Alaska Oil Spill Commission, among other things.

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Sponsor Statement

CSHB 277 (Oil & Gas)

"An Act relating to the powers of the Regulatory Commission of Alaska in regard to intrastate pipeline transportation services and pipeline facilities, to the rate of interest for funds to be paid by pipeline shippers or carriers at the end of a suspension of tariff filing, and to the prospective application of increased standards on regulated pipeline utilities; allowing the commission to accept rates set in conformity with a settlement agreement between the state and one or more pipeline carriers and to enforce the terms of a settlement agreement in regard to intrastate rates; and providing for an effective date."

HB 277 will clarify what jurisdiction the RCA has over state rates as they pertain to interstate and intrastate tariffs; it addresses the RCA's jurisdiction over State Right-Of-Way leases and will clarify their authority over dismantlement, removal, and restoration; it changes the applicable interest rate charged under RCA orders so that it conforms with the interest rate applied in other similar matters.

HB 277 will provide an environment that encourages both new and existing companies to continue investment and have certainty over future pipeline tariffs, the bill creates a business environment that supports a fair return of any pipeline owners investment, and provide the confidence that agreement with the state will be honored by all parties, while safeguarding the best interests of Alaskans.

Frank H. Murkowski, Governor

Alaska Department of Community and Economic Development

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April 25, 2003

Honorable Nancy Dahlstrom
Alaska State House of Representatives
State Capital
Juneau, Alaska

Dear Representative Dahlstrom:

Yesterday, I joined others at the Anchorage LIO for a hearing on House Bill 277. You and the Chairman agreed to take the bill up next week, giving Members a few more days to consider amendments to the original.

Since the bill would have such far-reaching impact on the Alaska Pipeline Act and on its administration, I thought you might wish to have the Commission's analysis now, while final wording is being considered.

Having received so many queries from other legislative offices on the impact of this legislation, I am taking the liberty of copying Members with the same information.

Best wishes,

Dave Harbour
Chairman

cc: Members, Alaska State Legislature

RCA CHAIR COMMENTS

Response to House Bill 277: April 24, 2003

Good afternoon Mr. Chairman and Members. I am Dave Harbour, Chairman of the Regulatory Commission of Alaska. I appreciate the opportunity to testify.

My duty and goal today is to describe for you how the bill will change current law and affect the public interest.

House Bill 277 amends the Pipeline Act; undoing several recent RCA decisions on TAPS tariff rates and dismantlement issues, and preventing any future commission from resolving similar disputes. In November 2002 the RCA issued an order finding that the rates charged for intrastate shipments on the Trans Alaska pipeline from 1997 to 2000 were an average of 57% more than the reasonable costs that the carriers incurred to transport the oil. The Carriers were ordered to pay refunds, and to make additional filings so that cost based rates could be set prospectively. The estimated refunds owing to shippers who used TAPS between 1996 and 2000 are more than $80 million, plus interest. The Carriers have appealed that ruling. This draft legislation greatly limits the RCA's jurisdiction over the Trans Alaska Pipeline and all other pipelines in the state, both in the past and in the future. It undoes parts of the RCA's decision that was based on an extensive record that the parties have spent more than $18 million creating. The November order, which is available on our commission's website (http://www.state.ak.us/rca/orders/2002/P97004_151.pdf), exhaustively details the review of the evidence filed by the parties and the reasons for the decision that the industry sponsor(s) of this bill seek to reverse. You should be aware that HB 277 makes significant changes to the RCA's role in regulating all pipelines in response to one or two special interest parties attempting to reverse an RCA Order only affecting TAPS.

My ability to comment specifically about the provisions of this bill is limited by the fact that it addresses issues that are still pending before the RCA for decision. Major advocates of this bill are aware of that because they are party to those cases. I cannot comment in detail on the merits of their proposals without impairing my ability and commitment to sit as an impartial decision-maker on those important cases. I can discuss the broader policy implications of what this bill proposes.

Passage of this bill would allow the pipeline owners (who are also the major producers on the North Slope) to set intrastate rates with no input from shippers other than the state. To the extent the Legislature seeks to improve Alaska's investment climate, it could make the climate for future development by small-scale producers less secure; thus possibly reducing the state's future revenue stream. The bill would allow the pipeline owners to set rates without oversight from the RCA, and could have a significant impact on the state's ability to recover royalty revenues from future producers of its resources.

What is being represented in this bill as a simplification of the pipeline rate setting process is likely to be more complex and litigious in its implementation than the current system. What is being presented as increasing investment clarity for producers and affiliated carriers could be later seen as decreased investment clarity for other players: explorationists, current and future shippers.

Allowing rates to be set by affiliated producers/carriers without input from the shippers who will be expected to pay them would violate their due process rights. Therefore, if passed in this form, the bill invites litigation in the Courts rather than regulatory treatment. The bill puts the state, presumably through the Department of Natural Resources that has statutory responsibility for managing the state's resource interests, in the position of protecting the public interest on pipeline tariffs. However, the state's economic interests in production and shipment of its oil may not always be consistent with all other current and future shippers. Being saddled with the responsibility to protect the interests of all shippers naturally conflicts with the state's ability to act to further its own economic interests, or may preclude other intrastate shippers seeking reasonable pipeline rates, from being represented.

The section of the bill that addresses the interest owing on refunds is properly within the Legislature's province to decide prospectively. Section 6 seeks to clarify the interest rate on refunds. However, Section 10 of the current version of this bill makes the interest rate changes effective retroactively, a change that could raise constitutional challenges from parties to the current TAPS litigation. As the Legislature considers changing the historical interest rate on refunds, it should evaluate its authority to do so retroactively, and what litigation an attempt to do so might spawn. The refunds owing

under the TAPS order are estimated to exceed $80 million. These funds were collected from shippers between 1996 and 2000; therefore, accrued interest is significant.

This bill would limit the Commission's jurisdiction, which is clearly defined in AS 42.06 and conforms to that of other state regulatory agencies. The Legislature intended that the Alaska Pipeline Act allow an objective, non-political commission to have broad regulatory responsibility. AS 42.06.245 states "nothing limits the powers of the commission set out in this chapter except to the extent they are preempted by Federal law." When considering the passage of AS 42.06.245, my dear friend, Senator Cliff Groh, who was the chairman of the legislative Committee that proposed the Pipeline Act, said, "The State attempted to regulate to the maximum extent possible, but would have neither the power nor the ability if preempted by federal law."[1] When considering the scope of the RCA's jurisdiction, the Legislature might be wise to explore to what extent Federal law preempts the Commission's jurisdiction. If the Legislature wants to further shape or limit the our jurisdiction, it would be essential to identify and look at the areas in which Federal law does not govern and consciously decide where jurisdiction should lie and where the Legislature consciously wishes to create a regulatory void.

This bill will also affect how the Commission regulates gas pipelines. We had previously responded to legislators' concerns that we could protect the public interest even when Contract Carriage language is included in the Alaska Pipeline Act. We must now inform the Legislature that we would be unable to act, under HB277, where pipeline owners reach a separate agreement with the State of Alaska. In recent hearings on HB204/SB151 we affirmed we could still regulate intrastate gas pipelines in the public interest where pipeline owners are allowed to employ contract carriage in their tariffs. With the proposed statutory language in HB 277, when the State reaches a settlement with a pipeline owner on its rates, the rates are considered to be just and reasonable. This effectively removes our ability to act on any protests from shippers who are not part of the settlement. Such settlements are likely to be similar to contract carriage agreements that were discussed during the HB204/SB151 hearings. We believe you will agree that the effect of this legislation is to move rate making from RCA public proceedings, into private negotiations between the State DNR/DOL and the Pipeline Owner, excluding other shippers.

We counsel the Legislature that while HB 277 addresses the interests of at least one TAPS owner at the expense of non-owners and future parties, it may also undermine the Legislature's intent to insure that future pipeline tariff rates are fair and reasonable. Attached is a section-by-section analysis of HB 277, which we hope you will find useful.

Thank you for this opportunity.

Section-by-Section: HB 277

Section 1

The proposed change to AS 42.06.140(a)(1) limits the RCA's authority over pipeline carriers that carry interstate and intrastate shipments. This limitation represents a major policy shift in the State's regulation of pipelines. Such a policy shift should only be considered after a comprehensive analysis of all the provisions of AS 42.06 as well as the provisions of AS 38.35, the Right-of-Way Leasing Act, which was passed as a companion act to the Pipeline Act in 1972.

Under AS 42.06.140(a)(2) the RCA now has jurisdiction concurrently with DNR concerning compliance with state pipeline right-of-way leases. The proposed change to that section would leave that authority solely with DNR.

The proposed changes would delete the word "facilities" from AS 42.06.140(a)(2) and (3), removing the RCA's authority to investigate pipeline facilities and order changes to facilities. The proposed change to AS 42.06.140(a)(8) would remove the RCA's authority to require a pipeline carrier to obtain a certificate to abandon a pipeline facility.

The RCA's authority over pipelines is in some ways more comprehensive than its authority over utilities. For example, no person can begin construction of a jurisdictional pipeline without a certificate from the RCA. Utilities do not require permission to construct facilities, only to operate them. The Legislature has given the RCA authority to act in the public interest to oversee pipeline facilities. As a practical matter, the RCA and APUC have not used that authority to affect pipeline location and routing because the pipelines that have been built in Alaska cross state land and DNR has taken the lead in such matters.

The proposed language in this section creates confusion because there are other provisions of AS 42.06 not subject to proposed amendments, which give the RCA explicit authority over facilities. AS 42.06.310 gives the RCA authority to require safe and adequate facilities and to order enlargement of pipeline facilities. AS 42.06.340 gives the RCA authority to order interconnection of pipeline facilities and physical changes to pipeline facilities.

Section 2

The proposed new subsection would remove RCA authority to oversee dismantling, removal and restoration (DR&R) of a pipeline and to oversee money collected for DR&R. Removal of RCA authority over DR&R would mean that there would be no regulatory authority over portions of a pipeline that do not cross state land. Portions of a pipeline that do cross state land would of course be subject to DNR's authority under the state pipeline right-of-way lease. In the case of pipelines that cross both state and federal lands, coordination and consistency to insure that the pipeline is adequately cleaned up before it is abandoned, could be lost.

Section 3

The proposed changes in this section clarify RCA jurisdiction over carriers that are subject to federal regulation. The amended language reflects current RCA practice except the proposed last sentence of AS 42.06.245. That sentence would prohibit the RCA from considering interstate revenues in setting intrastate rates. In order to insure that adequate funds are available to complete DR & R on state lands, the Commission needs to know how much has been collected through interstate rates. A flat prohibition on consideration of those revenues may result in higher intrastate rates. For example, on TAPS, intrastate shipments have historically been less than five percent of the volumes, but more than 50% of TAPS crosses state lands. Without the ability to consider interstate revenues, the intrastate rates may need to be increased to cover more of the DR & R responsibility. The last sentence of the current section, which HB 277 proposes to delete, is in the current statute to give the RCA the authority necessary to protect the interests of the state and intrastate shippers.

Section 4

The RCA has comprehensive authority over the construction of a pipeline. Removing the RCA's authority over abandonment of physical pipeline facilities would mean that the RCA would not have similar authority over the deconstruction phase of a pipeline. That change represents a major policy shift. While DNR would have authority over the deconstruction of portions of a pipeline on state land, there would be a regulatory void concerning Alaska portions of pipelines not on state land.

Section 5

The proposed new subsection would remove all RCA authority over intrastate rates for the entire term of any settlement reached by the State and a pipeline carrier. The State, which has not often chosen to include shippers in the process, whether interstate or intrastate, has negotiated past pipeline settlements. The pipeline settlements reached by the State in the past have been for very long terms, typically the expected life of the pipeline. If this subsection is enacted in its current form, intrastate shippers would be deprived of any input into the setting of intrastate rates they will pay for many years into the future. Interstate shippers will still be able to give their input to the FERC before the FERC makes a decision on the settlement.

Section 6

The proposed language in this section would change the rate of interest to be paid on refunds. This is an appropriate matter for legislative decision provided the new language applies to future periods. Applying it to past periods could raise constitutional questions.

Section 7

This proposed change is ambiguous. The RCA and APUC have consistently interpreted the present language of AS 42.06 to provide for two types of rate proceedings, one initiated by the pipeline carrier as a tariff filing and the other initiated either by the RCA or by complaint of a third party.

In a proceeding initiated by tariff filing, the tariff rate is suspended (does not become a permanent rate). Following the ad judicatory proceeding, the rate adopted by the RCA is put into effect as of the date the pipeline carrier proposed for its tariff filing. That is a historic date, sometimes several years in the past, depending on the length of the proceeding. However, putting such a rate into effect as of that date is not retroactive because there has not been a permanent rate during the suspension period.

In a Commission-initiated or complaint proceeding there is a permanent rate already in effect for the pipeline carrier, a rate that the pipeline carrier has not proposed to change. That permanent rate remains in effect until the RCA determines that it is not just and reasonable and sets a new rate. The new rate does not go into effect until at least the date of the RCA order setting the new rate.

If this proposed change to AS 42.06.410(a) is intended to apply to a proceeding initiated by tariff filing, the language is in conflict with the refund language in AS 42.06.400. If the proposed change is intended to apply to a Commission-initiated or complaint proceeding, the additional language is unnecessary.

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[i] Minutes of Senate Finance Committee, 8th Leg., 1st Sess. (Nov. 1, 1973 meeting).

Testimony Before the House Oil and Gas Committee (April 29, 2003)

My name is Robin O. Brena. I am an attorney with the firm of Brena, Bell & Clarkson in Anchorage, Alaska. I represent Tesoro Alaska Company with regard to its regulatory matters before the Regulatory Commission of Alaska ("RCA") and the Federal Energy Regulatory Commission ("FERC"). I am here today on behalf of Tesoro to testify in opposition to House Bill 277. Aside from a copy of my testimony, I have two additional handouts. The first has summary bullet points of my testimony. The second is a summary of the representations made at the time the owners of the Trans Alaska Pipeline System ("TAPS") entered into the existing TAPS Settlement with the State.

Tesoro employs over 500 Alaskans who operate a refinery and distribution system that supplies almost 50 percent of the petroleum products used in Alaska. Tesoro has been a good corporate citizen within Alaska for 35 years. As part of its Alaskan operations, Tesoro purchases crude oil from the Alaska North Slope ("ANS") and transports that crude oil through TAPS for processing in its refinery in Nikiski, Alaska.

It is of vital importance to Tesoro and the other value added Alaskan refiners as well as to independent producers exploring and developing the oil and gas resources in Alaska that the tariff rates they are required to pay to transport ANS crude oil be both fair and predictable. Tesoro and other value added refiners as well as independent producers have and are investing hundreds of millions of dollars within the State of Alaska creating jobs and adding value to the oil resources of Alaska. Companies investing in Alaska's future rely in large part upon the Regulatory Commission of Alaska ("RCA") to set rates that are both fair and predictable.

Recently, in a historic, well reasoned, and comprehensive decision, Order P-97-4(151) ("Order 151"), the RCA applied standard ratemaking principles and practices and set just and reasonable rates for TAPS. The RCA decision was the first time in 25 years of operation just and reasonable rates had been set for TAPS. In Order 151, the RCA properly pointed out that the TAPS owners had overcharged their shippers $9.9 billion from 1977 through 1996. The RCA held that Tesoro has paid tariff rates 70 percent greater than can be justified under standard ratemaking practices and procedures. To offer perspective, for the five years prior to Tesoro's 1997 protest of the TAPS rates, the TAPS owners had received a return on their remaining investment in excess of 100 percent per year.

These overcharges have been a tremendous burden on the viability, development, and continuing operation of the entire refining infrastructure in Alaska and have had a huge and negative impact on Tesoro's Alaskan operations.

House Bill 277 eliminates Tesoro's, and every other Alaskan ratepayers', right to contest the rates they are required to pay. If it passes, an oil pipeline in Alaska will be the only common carrier or utility in the United State in which the ratepayers have no legal right to contest the rates they are required to pay. Please imagine for a moment, your electric or water and sewer bill has been raised by 70 percent, the utility is realizing returns in excess of 100 percent per year, and your right to contest that rate and have the RCA set a just and reasonable rate has been eliminated.

Instead, House Bill 277 would have the State negotiate rates with the TAPS owners that the RCA would have to accept and Tesoro and other ratepayers would have to pay. It seems fundamental to any concept of due process that the person required to pay the rate be allowed the right to participate in the process of setting the price. It also seems fundamental to any concept of due process that rates would be set through an open process before a fair and impartial regulatory agency with knowledge and experience in ratemaking.

Moreover, Tesoro is concerned because the TAPS Settlement the State reached on TAPS established ceiling rates that are 70 percent higher than may be justified under standard ratemaking principles and practices. In fact, if the State had negotiated federal rates on TAPS that were consistent with the standard ratemaking practices and procedures adopted by the RCA in Order 151, the State's permanent fund would have at least $10 billion more and the future for the continued development of Alaska's natural resources would be far brighter

House Bill 277 eliminates all regulatory certainty that rates in Alaska will be just and reasonable. Just and reasonable rates mean rates that allow the pipeline owner an opportunity to recover its prudently incurred investment, to recover its prudently incurred operating costs, and to receive a reasonable return on its unrecovered investment. From any public policy or fundamental fairness perspective, Alaskan ratepayers should not be required to pay rates that are higher than just and reasonable rates. The Legislature should ensure that Alaskans' rates are just and reasonable by allowing the RCA the regulatory authority necessary to determine and set just and reasonable rates.

House Bill 277 violates both the spirit and intention of the TAPS owners existing TAPS Settlement with the State. The existing TAPS Settlement sets ceiling rates on TAPS. If the TAPS owners set their rates at or below those ceiling rates, the State has agreed not to protest their rates. Nothing in the existing TAPS Settlement sets the actual rates to be charged from the date of the settlement in 1986 forward. Nothing in the existing TAPS Settlement binds ratepayers or nonsignatory parties. Nothing in the TAPS Settlement restricts the ratepayers' right to protest excessive rates or the FERC's or the RCA's authority to set just and reasonable rates lower than the ceiling rates determined by the TAPS Settlement.

When presenting the TAPS Settlement to the FERC and the APUC for approval, both the TAPS owners and the State represented that ratepayers could protest future rates and, if there were a protest, the FERC and the RCA could set just and reasonable rates as though the TAPS Settlement were never approved. When approving the TAPS Settlement, the FERC and the APUC made clear that ratepayers could protest future rates and they could set just and reasonable rates as through the TAPS Settlement were never approved. Please refer to the second handout with regard to the hearing at which the TAPS Settlement was approved by the APUC. The Legislature should not be party to extending a bad deal to the nonsignatory parties it was never intended to apply to in the first place.

House Bill 277 eliminates the carefully constructed jurisdictional authority of the RCA to regulate common carriers in Alaska. The Joint Pipeline Impact Committee was a joint committee of the House and Senate formed to propose legislation for the regulation of common carrier pipelines in Alaska. The Joint Committee retained a nationally recognized regulatory expert, Professor Witherspoon, to review existing state and federal laws and to propose legislation for the regulation of common carrier pipelines in Alaska. Professor Witherspoon prepared the initial draft of both the Alaska Pipeline Act and the Right-of-Way Leasing Act. In drafting these sister acts, he ensured that the RCA's authority to regulate common carriers in Alaska would be based on both the inherent police powers of the State and the inherent power of the State to manage its own pr prietary affairs. The Legislature made very clear it intended for the State to regulate to the degree jurisdiction was not preempted by federal law. House Bill 277 compromises the regulatory authority of the RCA to properly regulate and upsets the deliberate and well considered intention of the Legislature to maximize the State's ability to n.anage its own affairs. The Legislature should not compromise the basis for the RCA's jurisdictional authority and the State's own ability to manage its own affairs

Finally, House Bill 277 seeks to influence or determine the outcome of ongoing rate proceedings pending before the RCA and the Alaskan courts. The issues raised by the proposed changes to the Alaska Pipeline Act are pending before the RCA or the Alaskan courts. To cite a few examples:

(1) The TAPS owners have sought through litigation to extend their existing settlement agreement (and future settlement agreements) to ratepayers. Both the APUC and the RCA properly found such claims meritless. This issue is pending before the Alaskan courts on appeal.

(2) The TAPS owners have sought to have the lower interest rate approved by the Legislature through tort reform applied to their excessive over collections of common carrier rates. (As a side matter, the existing interest rate is too low and encourages the TAPS owners to file unsupportable rates.) Interestingly, before the RCA they argued that the lower interest rate was required by existing law while before this Legislature they take the position that the lower interest rate is not required by existing law and the existing law should be changed. Regardless, this issue is currently pending before the RCA.

(3) The TAPS owners have sought to avoid the RCA's full jurisdiction over DR&R. This issue is pending before the RCA.

In effect, every proposed change to the Alaska Pipeline Act seems designed to politically change or legally strengthen the TAPS owners' losing positions in ongoing rate proceedings pending before the RCA and the Alaskan Courts. Just and reasonable rates should not be set through a political process in Juneau but through a ratemaking process before the RCA. The Legislature should allow these issues to be fully and fairly considered in the pending rate proceedings by the RCA and the Alaskan courts. There is no reason for Alaska to be the first state to allow just and reasonable rates to be set behind closed doors in negotiations in which the ratepayers may not even participate. Similarly, there is no reason for Alaska to compromise the jurisdictional authority of the regulatory agency charged with the responsibility regulating common carrier pipelines. Please vote against passing House Bill 277 out of committee. I would be happy to respond to any questions you may have. Thank you for your consideration.

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STATE OF ALASKA

REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Will Abbott
Dave Harbour
Bernie Smith
James S. Strandberg

In the Matter of the Correct Calculation and Use of Acceptable Input Data to Calculate the 1997, 1998, 1999, 2000 and 2001 Tariff Rates for the Intrastate Transportation of Petroleum Over the Trans Alaska Pipeline System Filed by AMERADA HESS PIPELINE CORPORATION; ARCO TRANSPORTATION ALASKA, INC.; BP PIPELINES (ALASKA) INC.; EXXON PIPELINE COMPANY; MOBIL ALASKA PIPELINE COMPANY; PHILLIPS ALASKA PIPELINE CORPORATION; and UNOCAL PIPELINE COMPANY; PHILLIPS TRANSPORTATION ALASKA, INC.; and WILLIAMS ALASKA PIPELINE COMPANY, L.L.C., and the Protest by TESORO ALASKA PETROLEUM COMPANY of the 1997 and 1999 Tariff Rates	P-97-4
In the Matter of the Petition of TESORO ALASKA PETROLEUM COMPANY for an Investigation into the Amounts Collected by AMERADA HESS PIPELINE CORPORATION; ARCO TRANSPORTATION ALASKA, INC.; BP PIPELINES (ALASKA) INC.; EXXON PIPELINE COMPANY; MOBIL ALASKA PIPELINE COMPANY; PHILLIPS ALASKA PIPELINE CORPORATION; and UNOCAL PIPELINE COMPANY for Dismantling, Removal, and Restoration of the Trans Alaska Pipeline System	P-97-7

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CALENDAR:
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INDICATED TAPS CARRIERS' INITIAL BRIEF ON INTEREST RATE

App. A-E

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INTRODUCTION

As directed by Order No. 154,[1] the Indicated TAPS Carriers[2] hereby file their initial brief on "what rate of interest that should be awarded for refunds owing for 1997-2000,"[3] that the Commission ordered to be calculated pursuant to Order No. 151,[4] assuming that the refund award is upheld following judicial review. As discussed below, the applicable rate of interest is the statutory rate applicable to interest on judgments and decrees for the payment of money.

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[1] Order Setting Procedural Schedule for Briefing on Interest Due on Refunds and Requiring Filing, P-97-4 (154)/P-97-7 (113), January 29, 2003 ("Order No. 154").

[2] The Indicated TAPS Carriers are Amerada Hess Pipeline Corporation, BP Pipelines (Alaska) Inc., ExxonMobil Pipeline Company, Mobil Alaska Pipeline Company, Phillips Transportation Alaska, Inc., and Unocal Pipeline Company.

[3] Order No. 154 at 2. The Commission's Order assumes that the Commission has authority under the Pipeline Act to award interest in this procedural context and accordingly directs the parties to file briefs on "what rate of interest should be awarded . . .". Order No. 154 at 2. The Indicated TAPS Carriers' initial brief proceeds on that assumption and addresses the issue that the Commission has directed the parties to brief. AS 42.06.400(b), which addresses the suspension and adjudication of initial tariffs, is the only provision of the Pipeline Act that expressly confers authority to award interest on refunds. AS 42.06.400(c), which addresses the suspension and adjudication of revised, increased tariffs, contains no similar provision that expressly authorizes the Commission to award interest on refunds. Thus, if the Indicated TAPS Carriers' intrastate rates for 1997-2000 are viewed as revised rates rather than initial rates, there could be a question as to whether interest may be awarded in this procedural context. Therefore, while the Indicated TAPS Carriers address herein "what rate of interest should be awarded for refunds," as directed by Order No. 154, they do not concede that the Commission has statutory authority to award interest in this procedural context.

[4] See Order P-97-4 (151)/P-97-7 (110) at 161, 167, November 27, 2002.

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DISCUSSION

1. If the Commission Has Statutory Authority to Award Interest, the Applicable Rate of Interest on Refunds Is the Rate Applicable to Interest on Judgments and Decrees for the Payment of Money.

The Commission's order to pay refunds was a "judgment or decree for the payment of money" within the meaning of AS 09.30.070(a). That statute states:

> Notwithstanding AS 45.45.010, the rate of interest on judgments and decrees for the payment of money, including prejudgment interest, is three percentage points above the 12th Federal Reserve District discount rate in effect on January 2 of the year in which the judgment or decree is entered, except that a judgment or decree founded on a contract in writing, providing for the payment of interest until paid at a specified rate not exceeding the legal rate of interest for that type of contract, bears interest at the rate specified in the contract if the interest rate is set out in the judgment or decree.

(Emphasis added). This statute was amended in 1997 and is applicable to all judgments and decrees for the payment of money, "notwithstanding AS 45.45.010."

Concerning interest on refunds under the Pipeline Act, AS 42.06.400(b) states, in relevant part,

> The amount, if any, by which the permanent tariff exceeds the temporary tariff, shall be paid by the shipper to the carrier, or, if the temporary tariff exceeds the permanent tariff, the difference shall be paid by the carrier to the shipper, and in either event such payment shall be made with interest calculated on the balance due at the end of each calendar month at the legal rate, as defined in AS 45.45.010(a).

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(Emphasis added). Thus, the Pipeline Act does not prescribe an interest rate directly, but rather makes reference to AS 45.45.010(a).[5] However, the language referring to AS 45.45.010(a) was incorporated by statutory amendment in 1978, nineteen years prior to the statutory amendment to AS 09.30.070(a). See § 1, ch.. 22 SLA 1978. The more recent amendment to AS 09.30.070(a) expressly supersedes the 1978 reference to AS 45.45.010(a) ("Notwithstanding AS 45.45.010(a) . . .").

The reference to AS 45.45.010(a) in AS 42.06.400(b) must be considered within a proper historical context. It is important to note that during the historical period when AS 45.45.010(a) applied to prejudgment interest, the legislature maintained continuity between the rates of interest provided for by AS 09.30.070(a) and AS 45.45.010(a). In 1978, when the legislature provided for interest on refunds by including reference in the Pipeline Act to AS 45.45.010(a), both that statute and AS 09.30.070(a) specified the same rate of interest. This is readily seen by a comparison of the two statutes as they appeared in 1978. See Appendix A (1976 version of AS 45.45.010(a), which remained in effect until 1980) and Appendix B (1969 version of AS 09.30.070(a), which remained in effect until 1980) (both specifying an interest rate of 8 percent per year). In 1980, both statutes were amended to provide for an interest rate of 10.5 percent per year.[6] See Appendix C (chapter 107 SLA 1980, amending both AS 45.45.010(a) and

[5] AS 45.45.010(a) states, "[t]he rate of interest in the state is 10.5 percent a year and no more on money after it is due except as provided in (b) of this section." AS 45.45.010(b) addresses the permissible maximum rate of interest on contracts or loan commitments of $25,000 or less, and is not relevant to this discussion.

[6] In 1980, when the legislature raised the interest rate to 10.5 percent in both statutes, interest rates were quite high. In 1980, the prime rate was more than 15 percent and in 1981 it was nearly 19 percent, according to Federal Reserve System data. See Appendix E. Interest rates in 1980 and 1981 were higher than at any other time during the past fifty years. Id.

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to provide the prevailing party with a windfall. See Farnsworth, supra, 638 P.2d at 184 ("an award of interest is not penalty, but compensation. . ."); see also Haskins v. Shelden, 558 P.2d 487, 494-95 (Alaska 1976) (holding prejudgment interest inappropriate on punitive damage award where jury likely assessed punitive damages defendant should pay at time of trial, not at time of injury); Sebring v. Colver, 649 P.2d 932, 936 (Alaska 1982) (holding award of prejudgment interest on nondiscounted award of future damages constitutes an impermissible double recovery); Bevins v. Peoples Bank & Trust Co., 671 P.2d 875, 881 (Alaska 1983) (purpose of awarding interest is to compensate, not penalize); Liimatta v. Vest, 45 P.3d 310, 322 (Alaska 2002) (prejudgment interest should not be awarded on funds previously advanced to compensate plaintiff). By changing AS 09.30.070(a) in 1997 to conform more closely to prevailing interest rates, the legislature cured a problem that otherwise exists when a fixed rate of interest in such a statutory provision no longer conforms to economic reality. The legislature addressed the problem in 1997 so that the rate of interest applied to judgments and decrees for the payment of money would no longer be out of step with economic reality. Because the legislature intended interest on refunds under the Pipeline Act to conform to the interest rate applicable to judgments and decrees for the payment of money, the 1997 amendments to the Code of Civil Procedure must be applied in this instance to conform to the intent of the legislature.

AS 45.45.010(a) is not a prescriptive statute, and never has been. It has long been held that AS 45.45.010 is not a law prescribing interest on anything, but rather one that simply fixes the maximum limit on the rate that may be charged in certain instances. See State v. American Can Co., 362 P2d 291, 296 (Alaska 1961) (refusing to rely on earlier version of AS 45.45.010(a) as basis for awarding interest because it "is not a law prescribing interest on

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anything."). Accordingly, AS 45.45.010 is properly addressed to concerns about usury rather than being prescriptive. See American Can, supra, 362 P.2d at 296; see also Metcalf v. Bartland, 491 P.2d 747, 749 (Alaska 1971) (describing AS 45.45.010 as "the usury statute"). Moreover, by its own terms, if the limitations on interest provided for in AS 45.45.010 are "inconsistent with the provisions of any other statute covering maximum interest . . . then the provisions of the other statute prevail." AS 45.45.010(h) (emphasis added). The legislature made it clear in 1997 that AS 09.30.070(a), not AS 45.45.010, now governs the maximum rate of interest on all "judgments and decrees for the payment of money." Because the rates now contained in the two statutes are inconsistent, pursuant to AS 45.45.010(h), the rate prescribed by AS 09.30.070(a) prevails.

The reference to AS 45.45.010(a) that was inserted into AS 42.06.400(b) in 1978 must not only be read in its proper historical context, but also must be construed harmoniously with other provisions of the Pipeline Act. See City of Anchorage v. Scavenius, 539 P.2d 1169, 1174 (Alaska 1975) ("each part or section [of a statute] should be construed with every other part or section so as to produce a harmonious whole."); see also Rydwell v. Anchorage School District, 864 P.2d 526, 528 (Alaska 1993).

A refund order issued by this Commission is a judgment or decree for the payment of money that is capable of being enforced only by court order or judgment. See AS 42.06.480.[8] An order of the Commission to pay refunds is also a final, appealable order,

[8] AS 42.06.480 states:

> **Sec. 42.06.480. Review and enforcement.** (a) All final orders of the commission are subject to judicial review under AS 44.62.560 - AS 44.62.570. (b) If an appeal is not taken from a final order of the commission within 10 calendar days, the commission may

(Continued ...)

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which in this case has been appealed.[9] If the requirement to pay refunds contained in Order No. 151 is upheld on appeal, the refund requirement will at that point have been reduced to a court order or judgment, to which AS 09.30.070(a) will be directly applicable. Because the legislature did not give the Commission the power to enforce its own orders, but rather provided that Commission Orders would be enforceable by the Superior Court, see AS 42.06.480, it is clear that the legislature has never intended to provide for a different rate of interest applicable to refunds under the Pipeline Act than is applicable to judgments or decrees for the payment of money under AS 09.30.070(a). AS 42.06.480 is additional evidence of the statutory imperative that requires consistency between the rate of interest applicable to refunds and to judgments or decrees for the payment of money.

The Pipeline Act requires just and reasonable rates. AS 42.06.370(a) ("[a]ll rates demanded or received by a pipeline carrier, or by two or more pipeline carriers jointly, for a service furnished or to be furnished shall be just and reasonable."). This requirement applies both from the standpoint of shippers and from that of pipeline carriers. If refunds which may depending upon the circumstances be paid either by carriers or by shippers are calculated using an interest rate that is far in excess of the prevailing cost of money, the inevitable result will be that rates fixed for past periods will not be just and reasonable. The net effect of applying an interest rate that bears no relationship to current economic reality is that shippers will pay either too much or too little. Applying the 10.5 percent interest rate in this instance would be unfair to

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> apply to the superior court for enforcement of this chapter, the regulations adopted under it, and the orders of the commission. The court shall enforce the order by injunction or other process.

[9] See Indicated TAPS Carriers' Notice of Appeal, Superior Court for the State of Alaska, Third Judicial District at Anchorage, Case No. 3AN-02-13511 CI, December 6, 2002.

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the Indicated TAPS Carriers, but applying the same rate in differing circumstances could be equally unfair to shippers. Applying the rate prescribed by AS 09.30.070(a), which is designed to conform more closely to current economic reality, is consistent with the statutory imperative that rates be just and reasonable.

2. If There Is Any Ambiguity About Which Interest Rate Should Apply Here, That Ambiguity Must Be Resolved in Favor of the Market-Based Rate Contained in AS 09.30.070(a) Because Application of the Usury Rate Contained in AS 45.45.010(a) Would Raise Serious Constitutional Issues.

As set forth above, the intent of the legislature is clear that AS 09.30.070(a) should govern the interest rate on judgments and decrees for the payment of money, including refunds under the Pipeline Act. However, to the extent there is any ambiguity on that question, the Commission must resolve that ambiguity in favor of the interpretation that most closely supports the constitutionality of the applicable statutes. "A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score."[10] Here, requiring the Indicated TAPS Carriers to pay a 10.5 percent rate of interest under AS 45.45.010(a) would create substantial constitutional doubts in at least two significant ways.

[10] Almendarez-Torres v. United States, 523 U.S. 224, 237-38 (1998) (quotations and citation omitted); see also Public Citizen v. Dep't of Justice, 491 U.S. 440, 466 (1989) ("where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress."); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 30 (1937) ("The cardinal principle of statutory construction is to save and not to destroy."); Chenega Corp. v. Exxon Corp., 991 P.2d 769, 785 (Alaska 1999) ("Where it is reasonable to do so, we will construe a statute to avoid constitutional problems."); Bonjour v. Bonjour, 592 P.2d 1233, 1237 (Alaska 1979) ("If constitutional issues are raised, we have a duty to construe the statute, where it is reasonable to do so, to avoid dangers of unconstitutionality.").

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First, if applied here, the 10.5 percent interest rate would result in a "taking" of the property of the Indicated TAPS Carriers because it is clearly excessive in relation to its purpose. See U.S. Const. amend. V, XIV; Alaska Const. art. I, § 18.[11] The purpose of prejudgment interest is to compensate the prevailing party, not to overcompensate that party or to punish the losing party.[12] Here, the 10.5 percent interest rate would not only overcompensate the parties entitled to refunds, but it would generate a windfall unrelated to compensation for the use of money. Through AS 09.30.070(a), the legislature has indicated what it believes the appropriate market rate of interest is for "decrees for the payment of money" during the period in question. At no time during that period has the market-based interest rate been as high as 10.5 percent.[13] In fact, in 2002 and 2003 the market-based interest rates of 4.25 percent and 3.75 percent, respectively, are less than half of the fixed 10.5 percent rate contained in AS 45.45.010(a), resulting in a significantly greater disparity than existed in 1997, when the legislature amended AS 09.30.070(a). Such a gross disparity as now exists between the 10.5

[11] Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164 (1980) (Takings "Clause stands as a shield against the arbitrary use of governmental power.").

[12] See Bevins v. Peoples Bank & Trust Co., 671 P.2d 875, 881 (Alaska 1983) ("The purpose of awarding prejudgment interest is not to penalize the losing party, but rather to compensate the successful claimant for losing the use of the money between the date he or she was entitled to it and the date of judgment."); see also Osterneck v. Ernst & Whinney, 489 U.S. 169, 174 (1989) ("prejudgment interest traditionally has been considered part of the compensation due plaintiff"); West Virginia v. United States, 479 U.S. 305, 311 n.2 (1987) (purpose of prejudgment interest is "to compensate for the loss of use of money due as damages from the time the claim accrues until judgment is entered, thereby achieving full compensation for the injury those damages are intended to redress.").

[13] See Appendix D (Alaska Court System website memorandum, entitled "How to Determine Pre- and Post-Judgment Interest Rates -- 2003").

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percent rate contained in AS 45.45.010(a) and the rate prescribed by AS 09.30.070(a) is in no way consistent with the requirement that, in order to avoid a "taking," the deprivation of property must result in "a fair approximation of the costs of benefits supplied." United States v. Sperry Corp., 493 U.S. 52, 60 (1989).[14] The application of the 10.5 percent rate would be excessive by any reasonable measure.

Second, applying AS 45.45.010 here would violate both due process and equal protection because it would create an arbitrary distinction between similar groups of people. While legislatures have broad discretion in structuring classifications, such classifications must satisfy rational basis scrutiny. See e.g., Nordlinger v. Hahn, 505 U.S. 1, 11-12 (1992); Zobel v. Williams, 457 U.S. 55, 61-65 (1982) (invalidating system for distribution of Alaska dividend payments based on length of residency in the state). As an utterly arbitrary assessment, the 10.5 percent rate of interest could not survive even a minimal level of rational basis scrutiny. There is no justification or regulatory purpose for forcing the Indicated TAPS Carriers to pay a substantially higher interest rate than the one applicable to other industry groups and individual defendants under AS 09.30.070(a). Even if such a distinction had been intended by the legislature (and there is no evidence that it was), the distinction would be purely arbitrary and therefore invalid under both the federal and state constitutions.[15]

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[14] See also Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 163 (1980) (holding government could not confiscate interest from accounts held by court clerks because it was "not reasonably related to the costs of using the courts").

[15] Compare Turner Construction Co., Inc. v. Scales, 752 P.2d 467 (Alaska 1988) (six-year statute of repose on suits against design professionals discriminated irrationally against all others involved in a construction project; statute declared unconstitutional), and Gilman v. Martin, 662 P.2d 120 (Alaska 1983) (residency requirement for participating in a land sale lottery was unreasonable; ordinance invalid under equal protection clause), with McConkey v.

(Continued ...)

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In sum, application of the 10.5 percent interest rate here would raise substantial doubts about the constitutionality of the statutory scheme for interest on refunds. Under well-established precedent, the Commission should therefore construe the relevant statutory provisions to avoid raising those serious constitutional issues.

3. The Rate of Interest Prescribed by AS 09.30.070(a), as Amended, Should Be Applied to All Refund Amounts That Accrued on or After August 7, 1997.

The 1997 revisions to AS 09.30.070(a) apply to "causes of action accruing on or after August 7, 1997." Section 55, ch. 26 SLA 1997. The Pipeline Act prescribes the calculation of refund amounts on a calendar month-by-month basis. See AS 42.06.400(b) (directing that the difference between temporary and permanent tariffs be determined and "such payment shall be made with interest calculated on the balance due at the end of each calendar month . . . .") (emphasis added). Thus, amounts due as refunds under Section 400 of the Pipeline Act must be considered to accrue on a calendar monthly basis.

In Hanson v. Kake Tribal Corp., 939 P.2d 1320 (Alaska 1997), the Alaska Supreme Court considered monthly payments made by an Alaska Native Claims Settlement Act corporation to some of its shareholders. The monthly payments were life insurance benefits that the native corporation had purchased on behalf of its elderly shareholders. Other shareholders sued, claiming discrimination among shareholders. The Alaska Supreme Court held that a separate cause of action accrued with each monthly payment. See Hanson, supra, 939 P.2d at 1325. See also Bibo v. Jeffery's Restaurant, 770 P.2d 290, 294 (Alaska 1989) ("each excessive

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Hart, 930 P.2d 402 (Alaska 1996) (upholding constitutionality of statutory limitation on the accrual of prejudgment interest for victims of particular torts where there were explicit legislative findings that the classification was designed to advance tort reform objectives).

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payment is a separate wrongful act"). Cf. Trustees of Alaska Laborers v. Ferrell, 812 F.2d 512, 517 (9th Cir. 1987) ("a failure to make monthly payments in a contract which requires continuing performance results in a new breach every month"). Under the Pipeline Act, a balance is due at the end of each calendar month. Each payment is therefore a separate act for purposes of determining when a cause of action accrues.

In addition, the intrastate rates at issue for three of the four years in question all went into effect after August 7, 1997. Causes of action concerning those rates therefore could have accrued only after August 7, 1997. Therefore, AS 09.30.070(a) applies to all refunds that accrued on or after August 7, 1997.

Prior to August 7, 1997 the applicable rate of interest was 10.5 percent per year. However, refunds that accrued on or after that date must be considered new causes of action that accrued on a monthly basis. Accordingly, all refunds that accrued after August 7, 1997 are governed by the interest rate specified in AS 09.30.070(a). AS 09.30.070(a) specifies that rate as "three percentage points above the 12th Federal Reserve District discount rate in effect on January 2 of the year in which the judgment or decree is entered . . ." (emphasis added). The Commission's order to pay refunds was entered on November 27, 2002. Therefore, the interest rate in effect on January 2, 2002 applies to the refund order. That rate is 4.25 percent per year. See Appendix D. (Alaska Court System website memorandum entitled, "How to Determine Pre- and Post-Judgment Interest Rates -- 2003.)"

CONCLUSION

For refunds that accrued prior to August 7, 1997, the applicable rate of interest is 10.5 percent, the rate then applicable to judgments and decrees for the payment of money. For

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refunds that accrued on or after August 7, 1997, the applicable rate of interest is 4.25 percent, the rate specified by AS 09.30.070(a) for decrees for the payment of money entered in 2002.

DATED at Anchorage, Alaska, this 19th day of February, 2003.

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CERTIFICATE OF SERVICE

This is to certify that on the 19th day of February, 2003, a true and correct copy of the foregoing was faxed and hand-delivered to the persons identified on the attached service list.

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III. State of Alaska's Representations as to the TAPS Agreement.

The State approached the FERC and the APUC with the TAPS Agreement and asserted that it would be in the public interest to allow the State and the TAPS Carriers to resolve their dispute by way of the proposed settlement rather than continue time-consuming and expensive litigation. The State asked the FERC and the APUC not to consider whether the TSM ceiling rates were "just and reasonable" rates, but instead requested the TAPS Agreement be approved as a settlement that was in the public interest. The State explained to the FERC and the APUC that the TAPS Agreement only bound the signatory parties, and that the Commissions should consider the "justness and reasonableness" of future rates as though the TAPS Agreement never existed.

To cite a few examples, the State made the following representations to the APUC when the Agreement was submitted for approval:

> [T]he Commission retains full jurisdiction over intrastate TAPS tariffs; ***any non-signatory to the agreement*** (who has the requisite standing) ***may seek to challenge a tariff filed pursuant to the settlement regardless of whether the tariff complies with the terms of the settlement.***

Brief of the State of Alaska in Support of Commission Approval of the Offer of Settlement, August 7, 1986, at 3, n.1 (emphasis added).

The State also made numerous similar representations in its reply brief submitted to the APUC:

> Alaska and the TAPS Carriers have explicitly asked the Commission to approve the settlement on the basis that Petro Star, AEC and ***future shippers not be bound by the agreement's terms.***

* * *

[T]his ***Commission is absolutely free*** – as it should be – ***to establish whatever TAPS tariff rates*** it finds are consistent with the statutory requirement.

* * *

Alaska and the TAPS Carriers have not urged the Commission to approve the settlement agreement as an adjudication of "just and reasonable" rates.[2] Instead, they have urged the Commission to approve the agreement as a fair and reasonable resolution of the conflicting claims of the parties who have actively participated in this litigation for the last ten years and who will be bound by its terms.

* * *

By approving the settlement on these terms, the Commission gives those parties the benefit of their bargain, while ***fully preserving the***

---

[2] In contrast to their position in 1987, the State is now asking the RCA to treat the TSM-based rates set forth in the settlement agreement as "just and reasonable."

> Q. [H]ave you formed an opinion as to whether the TAPS Settlement tariffs are just and reasonable?
>
> A. Yes.
>
> Q. What is the basis for your conclusion?
>
> A. .... Based on my experience and knowledge, I believe the tariff rates arising from the TSM were and continue to be just and reasonable. I recommend that the Commission find them so.

Prepared Direct Testimony of Jerome E. Hass, December 10, 1998, P-97-4, at 9. See also, Motion for Leave to File Pre-Hearing Submission of the State of Alaska and Pre-Hearing Submission of the State of Alaska, P-97-4, October 8, 1998, at 3. ("The Settlement Agreements have also provided a ceiling for TAPS tariffs that ensures that such tariffs are just and reasonable.")

> ***rights of Petro Star, AEC and future shippers to seek even lower tariffs if they desire.***
>
> * * *
>
> ***[T]here is no way for the Commission to evaluate today whether future TSM rates will be "just and reasonable."*** The Commission, of course, ***retains the authority to review future settlement tariffs at the time they are filed, and make "just and reasonableness" determinations at that time.***

Reply Brief of the State of Alaska in Support of Commission Approval of the Offer of Settlement, January 15, 1987, at 4-5, 11, 15, 19-20 (emphasis added).

The APUC Commissioners were somewhat surprised to learn that the TAPS Agreement did not settle the issue of all tariffs for all parties.[3] Specifically, the Commissioners questioned the State's lawyers about the rights of shippers who were not parties to the TAPS Agreement. The State's lawyers clarified that the State had no intention of imposing the TAPS Agreement on shippers such as Tesoro who were not parties to it.

> **Commissioner Knowles:** Do you believe then that – let's say ***if a shipper were to protest the application of the settlement in five or ten years from now that it would be conceivable that the ceiling rates could be reduced at that time on the basis that they were not just and reasonable,*** looking at them at that single point in time?

---

[3] The State represented to the Commission that intrastate rates for nonsignatory shippers would continue to be determined under the terms of the Alaska Pipeline Act just as it told FERC that interstate rates for nonsignatory shippers would continue to be determined under the terms of the Interstate Commerce Act. "The Settlement Agreement does not restrict the rights of any nonsignatory to challenge tariffs under the Interstate Commerce Act, ***nor could it.***" Reply Comments of the State of Alaska, April 11, 1986, FERC Docket Nos. OR 78-1-041, 042, 043, and Docket No. IS84-13-000 at 18 (emphasis added).

> **Mr. Loeffler:** Here I come. The answer is *yes*. . . . With respect to future tariffs, I think the State has consistently said that the Settlement Agreement is, in effect, a contractual mechanism for putting a cap on future tariffs. But if, for example, Petro Star thought in 1995 that the tariff filed according to the settlement cap was not just and reasonable in that particular year, then yes, Petro Star could challenge it on that basis, and indeed, if the Commission found validity in Petro Star's complaint, could lower the tariff at that time.
>
> * * *
>
> **Commissioner Agi:** But there's still a very subtle point involved here. ***There is nothing in this Agreement that binds any shipper to this proceeding***, and you just told us they're at liberty to pursue, and there is nothing here that presumably binds the Commission itself, acting through its Staff, to litigate the propriety of the proposed tariff. I would think you would have to agree with that. If not...
>
> **Mr. Maynard:** *We believe that's correct.*

Voir Dire Examination of Dr. Horst (State of Alaska's expert witness) by Commissioners Knowles and Agi and Responses by State of Alaska outside counsel Robert Loeffler and Assistant Attorney General Robert Maynard, January 28, 1987, at 226-30 (emphasis added).

IV. TAPS Carriers' Representations as to the TAPS Agreement.

It is worth noting, that the State and the TAPS Carriers were in agreement regarding the scope and nature of the TAPS Agreement. The TAPS Carriers told the Commissions much the same thing as did the State. In their Initial Post-Hearing Brief in Support of the Offer of Settlement, the TAPS Carriers said,

> ***The Commission is not being asked to determine that TSM generates rates – either for the past or the future – that are "just and reasonable" in and of themselves.***

Initial Post-Hearing Brief of the TAPS Carriers in Support of the Offer of Settlement, March 13, 1987, at 3 (emphasis added). Similarly, the TAPS Carriers wrote,

> ***The settling parties are not asking the Commission to approve at this time the rates to be charged in 1990 and later years.*** To the contrary, as the settling parties have repeatedly stated, TSM simply sets forth voluntary rate ceilings that the TAPS Carriers have agreed not to exceed in filing their future tariffs. ***If the Staff finds that the rates set under TSM in 1995 are too high, that issue can be addressed at that time.***

Reply Brief of the TAPS Carriers in Support of Offer of Settlement, January 16, 1987, at 23 (emphasis added). Finally,

> While the Commission's legislative mandate speaks of "just and reasonable" rates, [citation] that standard must be met by the parties only when litigation results in a formal Commission decision on the merits. Where all settling parties agree on a rate structure, requiring full-scale proof would not only be unnecessary, but destructive of the settlement process.

Brief of the TAPS Carriers in Support of the Offer of Settlement, July 31, 1986, P-86-2, at 6 (citation omitted). Clearly, not even the TAPS Carriers asked the Commission to determine that TSM rates are "just and reasonable." Rather, the parties to the TAPS Agreement simply asked the Commission to let them cease litigating on the basis of their private agreement.

With regard to future rates, counsel for the TAPS Carriers, Steven Brose, told the APUC specifically that the TAPS Agreement does not prevent any nonsignatory party from challenging

TSM rates nor does it deprive the Commission of its duty and responsibility to determine just and reasonable rates. For example, Mr. Brose told the Commission,

> ***Nothing in the agreement deprives the Commission of its jurisdiction to look in the future at whether the TSM rates are unreasonably high***, nor does anything prevent any non-signor, Petro Star or Arctic Energy or whomever, from challenging those rates at any point in the future. In fact, the agreement requires that the Carriers file with the Commission every year revised tariff sheets and to provide the Commission with data sufficient to analyze the filings.

Opening Statement of Steven Brose on Behalf of the TAPS Carriers, January 27, 1987, P-86-2, at 47 (emphasis added). The TAPS Carriers also wrote in support of the offer of settlement:

> ***This agreement does not supplant this Commission's jurisdiction over intrastate rates.***
>
> * * *
>
> Other than the signatories of the agreement, ***no person is precluded from invoking the Commission's jurisdiction over TAPS intrastate rates to whatever extent that jurisdiction would exist absent the settlement.*** The Commission is thus not being asked to impose the settlement on unwilling parties with significant interests in the litigation.

Brief of the TAPS Carriers in Support of the Offer of Settlement, July 31, 1986, P-86-2, at 14 (emphasis added).

The TAPS Carriers also told the Commission that approving the TAPS Agreement between the State and the TAPS Carriers would not eliminate future TAPS tariff disputes. The TAPS Carriers made the following representations to this Commission.

> ***No other party is any worse off as a result of settlement than it would have been had the State never pursued this action in the first***

> ***place. Nor will any non-settling party be less able to invoke the Commission's remedial processes simply because the State and the TAPS Carriers have reached an agreement.***

Reply Brief of the TAPS Carriers in Support of Offer of Settlement, January 16, 1987, P-86-2, at 11 (emphasis added).

> ***If any non-signatory objects to the level of a future tariff rate, whether set within the confines of TSM or not, this Commission's processes remain available for the examination of that rate.***

Brief of the TAPS Carriers in Support of the Offer of Settlement, July 31, 1986, P-86-2, at 4.

> For the future, the intrastate settlement in essence limits the TAPS Carriers' discretion in setting tariff rates. So long as rates are set at or below ceilings calculated in accordance with TSM, the State of Alaska agrees not to challenge the rates. . . . Moreover, ***other than the signatories of the agreement, no person is precluded from invoking Commission jurisdiction over TAPS intrastate rates to whatever extent that jurisdiction would exist absent the settlement.*** The future TSM rate ceilings are the quid pro quo for the establishment of a fixed refund obligation for the past and the termination of the present litigation.
>
> * * *
>
> [B]ecause nothing in the agreement diminishes the Commission's jurisdiction, these [non-affiliated in-state] shippers ***are free to contest future rates and invoke the Commission's processes.***

Initial Post-Hearing Brief of the TAPS Carriers in Support of the Offer of Settlement, March 13, 1987, P-86-2, at 3 & 9 (emphasis added).

> The attack on the return allowance is based principally on the argument that it is not "cost-based" and therefore may result in excessive returns to the carriers in some years. This attack is both premature and misguided. It must be kept firmly in mind that ***the settling parties are not asking the Commission to approve the rates***

> ***to be charged in 1990 and later years. To the contrary, as the settling parties have repeatedly stated, TSM simply sets forth voluntary rate ceilings that the TAPS Carriers have agreed not to exceed in filing their future tariffs. If a party finds in [1995] that the rates set under TSM are too high, that issue can be addressed at that time.***

Post-Hearing Reply Brief of the TAPS Carriers in Support of the Offer of Settlement, April 3, 1987, P-86-2, at 19-20 (emphasis added).

> ***The settling parties are not asking this Commission definitively to endorse the future rate ceilings embodied in TSM.*** All the Commission is being asked to do, in order to permit implementation of the settlement, is to provide that the TAPS Carriers owe no further refunds beyond those provided in the Settlement Agreement, and therefore that the litigation regarding past TAPS tariff rates is terminated as to them.
>
> * * *
>
> ***With respect to non-settling parties, the settlement is structured to preserve in full any rights they may have to challenge TAPS rates, even if those rates are set in conformity with TSM.*** There is thus a theoretical possibility that ***a non-settling party might seek to institute new litigation in the future.***
>
> * * *
>
> ***No party – or non-party – is one penny worse off as a result of this settlement than it was before the settlement.*** TSM merely sets ceilings on the rates it is permissible for the TAPS carriers to file in the future. Within those ceilings, the rates still remain subject to Commission jurisdiction. ***Any party (other than the State) believing a rate is too high remains free to seek such relief as is available under governing law.*** Thus, while this settlement is primarily intended to be for the benefit of the parties to it, non-parties get the best of both worlds. They are the beneficiaries of the TSM ceilings, which limit the rates the TAPS carriers can set, while ***they sacrifice none of their rights that otherwise exist.***

Prepared Direct Testimony of Richard Hildahl on behalf of the TAPS Carriers, July 31, 1986, P-86-2, at 6, 10, 12-13 (emphasis added).

> [O]ne of the things that could indeed happen is that you agree to the Settlement, that the day you accept the Settlement, that a small shipper, or one of the participants here, files a complaint and says, "We do not believe that the tariffs currently are just and reasonable and we're into that process," but that's there whether or not you accept the Settlement. . . . [Y]our job does not go away. I personally believe it will be made easier if you accept the settlement. But ***there could be substantial proceedings in the future in front of this Commission with respect to disputes on the just and reasonableness of the tariffs on the pipeline.***

Response of Mr. Richard Hildahl (the TAPS Carriers' expert witness) to Voir Dire by Commissioner Knowles, January 29, 1987, P-86-2, at 391-92 (emphasis added).

V. By its Terms, The TAPS Agreement may not be Applied to Intrastate Shippers or Their Interstate Rates.

By its own terms, the TAPS Agreement may not be applied to nonsignatory parties. Section III-4 of the TAPS Agreement provides:

> Parties in Interest: This Intrastate Agreement shall be binding upon and inure solely to the benefit of the parties and their respective successors and assigns, including lessees. No obligation under this Intrastate Agreement shall be for the benefit of or be enforceable by any third party.

Intrastate Settlement Agreement at 19. Such an Agreement by its terms should not be applied to prevent this Commission or Tesoro, who is not a signatory, from exercising its rights under the Alaska Pipeline Act.

VI. APUC's Understanding of the State's and the TAPS Carriers' Representations.

In its 1987 approval of the TAPS Agreement, the Commission specifically reserved its right to adjudicate future TAPS rates. The Commission wrote:

> The settlement as explained by its proponents at the hearing and in their written submissions is acceptable because it is the ***Commission's understanding that it allows for continued adjudication of TSM as a basis for deriving current and prospective rates***; permits finalization of past period rates with liquidation of related refund obligations; and establishes ceilings on future rates which are specifically enforceable by this Commission.

APUC Order No. P-86-2(14) at 2 (emphasis added). In other words, the Commission resolved TAPS tariff issues for the past by terminating the proceeding but left open all TAPS rate issues since 1986.[4]

Further, in light of Petro Star's protest of intrastate TAPS tariffs, the Commission expressed its intention to investigate and take whatever action it deemed necessary to adjudicate just and reasonable rates.

> The Commission will first complete its investigation of the acceptability of using TSM to derive present and future rates. . . . If the Commission determines that TSM does not produce just and reasonable results or is not otherwise an appropriate methodology to be used in the calculation of intrastate TAPS rates, the Commission will proceed to fully adjudicate rates from July 11, 1986, forward. With respect to that adjudication, ***the Commission is entirely free to set just and reasonable rates according to whatever methodology the Commission finds to be appropriate for the regulation of TAPS.***

APUC Order No. P-86-2(14) at 5 (emphasis added).

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[4] According to the Commission, "**The signatories have stipulated that the Commission is free to adjudicate the acceptability of TSM rates prospectively.**" APUC Order No. P-86-2(14) at 2 (emphasis added).

When the TAPS Carriers settled with Petro Star in 1993, the Commission noted its intention to terminate the investigation under 3 AAC 48.090(d)(2). Even then, the Commission was careful to note, however, that all rates since 1986 would remain suspended subject to refund, that each annual rate is considered a new tariff filing, and that all issues remain to be adjudicated despite the Commission's acceptance of the TAPS Agreement.

> Notwithstanding the acceptance of the TAPS Settlement, ***the suspension of 1986, 1987, 1988, 1989, 1990, 1991, 1992, and 1993 TSM rates will not be vacated*** until the Commission determines that those filed rates were correctly calculated under the TSM and include acceptable input data.
>
> ***Each new rate filed by the TAPS Carriers under the Intrastate Settlement Agreement is considered to be a revised tariff filing under AS 42.06.400. The filing is subject to the same standards and procedures to which it would have been subject if the Intrastate Settlement Agreement had not been accepted.*** However, in the absence of a protest, the TAPS Carriers need not file the supporting material required by 3 AAC 48.275(a). Instead, the TAPS Carriers should file the TSM computer disk used in calculating the rate filed and a hard-copy printout of the rate calculation.
>
> ***The Commission's acceptance of the TAPS Settlement should not be construed as determining any issue which was raised in Docket P-86-2 or in the underlying TAPS litigation Dockets.***

APUC Order P-86-2(41) at 20-21 (emphasis added).

As can be seen, then, the Commission did not "approve" the TSM for resolving intrastate rates issues or "approve" the TSM to be used as a methodology to set just and reasonable rates under the Alaska Pipeline Act. To the contrary, it allowed the signatory parties to resolve their disputes and terminated the investigation into rates prior to 1986 and nothing more. Finally, reflecting a clear

understanding of the terms of the Agreement, the APUC approved the deal precisely because it allowed for continued adjudication of rates as to non-parties.

> The settlement as explained by its proponents at the hearing and in their written submissions is acceptable because it is the ***Commission's understanding that it allows for continued adjudication of TSM as a basis for deriving current and prospective rates***; permits finalization of past period rates with liquidation of related refund obligations; and establishes ceilings on future rates which are specifically enforceable by this Commission.

APUC Order No. P-86-2(14) at 2 (emphasis added).

Alaska State Legislature

House and Senate Democratic Caucus

Official Business, State Capitol, Juneau, Alaska, 99801

March 17, 2003

Dear Governor Murkowski,

We, the Democratic members of the 23rd Alaska Legislature, write this open letter urging you to consider reducing the tariff charged on the TAPS pipeline as an alternative to the taxes you have proposed. A tariff reduction will not only significantly close the fiscal gap, it is a critical incentive for future oil and gas exploration in Alaska.

On November 27, 2002, the Regulatory Commission of Alaska determined that tariff rates charged by the owners of TAPS for shipment of oil through the pipeline had "provided the Carriers an opportunity to earn over $9.9 billion more than the cost of providing service" since the opening of the pipeline (Petition of Tesoro Alaska Petroleum Company, Combined Orders No. 151 & 110, page 8 (Regulatory Commission of Alaska) (SP"RCA ruling"). Because TAPS has had a considerably longer useful life than originally expected, the RCA determined new cost-based rates that take this into consideration and still provide margin for the Carriers to recover a reasonable return on their investment. Calculations using these rates for the period from 1997-2000 show that the Carriers were charging the State of Alaska and other shippers of oil through TAPS a tariff that was 57% above cost-based rates. The TAPS settlement requires that the tariffs be "just and reasonable." A charge of 57% above the cost-based rate is not just and reasonable.

The RCA ruling directly applies only to the 10% of oil that is processed within the state. The other 90 percent of TAPS oil is governed by the Federal Energy Regulatory Commission (FERC) and no case has been filed before the FERC asking for a review of these rates. Because the RCA quoted extensively from FERC precedents and methodologies, there is reason to believe that the FERC would reach a conclusion similar to the RCA.

If the RCA decision applied to the FERC oil, the state would save between $85 million and $105 million per year. This is close to the total amount raised by the taxes and user fees you proposed in your State of the Budget speech, but does not take money from hard working Alaska families. We hope that you agree with us that the State of Alaska deserves to be charged a fair rate for transporting its oil, and we should make sure these rates are fair.

Even more important than the additional revenue, a reduction in the TAPS tariff encourages economic development in the oil industry. We believe that economic development should come before and hopefully make unnecessary any new taxes. In the January, 2003 issue of the

Petroleum News, representatives of the Alaska oil industry were polled on the most important things that government could do to encourage oil development. The result was a tie between "Lower TAPS tariff by $1.50 per barrel" and "Reduce permitting time, complexity" (Petroleum News, Vol. 8, No. 3).

The conclusion that lowering the TAPS tariff is important to the new independent producers of oil is a logical one. Currently, an independent oil company that strikes oil on the North Slope must use a transportation system owned by competitors to bring the oil to market. The only protection the independent company has is vigorous regulatory oversight of the tariff rates. If the tariff is allowed to stay unreasonably high, competition suffers, exploration declines and the state treasury suffers.

We recognize the practical challenges in lowering this tariff. The owners of TAPS have considerable political power and will argue that changing the tariff rate structure now is unfair. The RCA opinion specifically concluded that changing the tariff calculation as of 1996 would not deprive the TAPS carriers of a reasonable rate of return (RCA ruling, page 23). The provision in the TAPS settlement agreement attempting to force the state to defend this unfair rate structure also poses a difficulty.

Working together in a bipartisan manner, we can obtain a fair tariff for the oil we hold in trust for the people of Alaska. If we succeed together, then the people win. We avoid painful new taxes, take steps to closing the fiscal gap, and we remove a major hurdle to oil development.

We look forward to working with you on this issue.

Sincerely,

Senate Minority Leader Johnny Ellis

House Minority Leader Ethan Berkowitz

HB 277
Testimony by Al Bolea
Before the House Oil & Gas Committee

May 1, 2003

Thank you Mr. Chairman, for the opportunity to testify today on this important bill. For the record, my name is Al Bolea, and I am President of BP Pipelines and Performance Unit Leader for BP's mid-stream assets in Alaska, which include our interests in the Trans Alaska Pipeline System and the ships that carry Alaskan crude to West Coast markets.

I would also like to thank you and the other committee members for making the time to discuss this bill with me over the past week or so.

As you know, BP strongly supports HB 277, and encourages this committee to facilitate its movement through the legislative process.

We support this bill because it helps to correct many serious flaws that currently exist in the Alaska Pipeline Act. These flaws create uncertainty for current and potential future investments, and must be rectified to help ensure a healthy oil and gas business in Alaska.

In fact, these flaws are so significant they need to be addressed to ensure investment in risky projects like the Alaska Natural Gas Pipeline.

While I will not cover all of the deficiencies nor all of the recommended changes to the APA, I would like to touch on several key points.

The current language in the APA creates uncertainty over jurisdictional issues, creating unnecessary overlap between regulatory agencies. This has allowed

HB277 will have no effect on the existing agreement with the State, known as the TSM agreement. Tesoro and Williams are free to continue their challenge to TSM in the courts. Yet, you may have heard a lot about the assertedly exorbitant profits of the TAPS carriers under TSM. In order to put the record straight I feel compelled to explain a bit about the financial mechanics of TSM. But I'm not asking you to pass judgment today on TSM ... rather, we will defend TSM in the courts. For this purpose I would ask that you turn to Figures 1 and 2, attached to the end of my testimony.

It's important to note that actual rates charged by the carriers have been well below the originally projected TSM rates. Thus we find ourselves where TSM has performed better than expected from the shippers' perspective in every year since the contract was signed, but Tesoro and Williams are seeking to maximize their profits by "cherry picking" the original TSM deal. In fact, in its appeal of the RCA Order 151 the State's Attorney General stated, "the RCA ignored its own precedent, abused its discretion, and erred in fact and law." Moreover, when TSM was approved by the Department of Justice, they warned, and I paraphrase, *TSM was negotiated as a package... No single element of TSM should be evaluated independently... To do so would likely nullify the agreement.*

It is hard to believe how opinions can do an about-face based on self-interest. Remember, at the time TSM was agreed to, Tesoro's counsel said, The settlement "will provide certainty to the operating costs into the future." MAPCO's counsel Randy Jones said, "MAPCO Petroleum believes the settlement is fair and equitable and that it warrants the Commission's approval...". And the Dept. of Justice termed TSM a "comprehensive cost-

We invest in Alaska because it makes sense for our business, and it has been done in a way that has had mutual benefits for the residents of this State and our shareholders.

In closing my testimony, we believe those mutual benefits can and should continue.

Your support of HB 277 will help the State move forward in a very positive way. It is a bill vital to the future of this State; a bill that is one of the essential ingredients that can support an Alaska Gas pipeline becoming a reality.

Thank you again for allowing me to testify before this committee. I will try my best to answer questions at this time.

Please be aware that because of litigation currently underway on pipeline issues, I have asked our attorney, Jim Decker, to join me at the table to ensure I stay on point.

Thank you, Mr. Chairman.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

TRANS ALASKA PIPELINE SYSTEM	Docket No. OR 78-1
BP PIPELINES INC.	Docket No. IS83-29-000

EXPLANATORY STATEMENT OF THE STATE OF ALASKA AND THE UNITED STATES DEPARTMENT OF JUSTICE IN SUPPORT OF SETTLEMENT OFFER

THE STATE OF ALASKA

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Attorneys for the
U.S. Department of Justice

of petroleum.[1/] DOJ has stipulated to the entry of an order by the Commission adopting that Agreement as the complete and final resolution of the protests against the tariffs of the settling carriers.[2/] The Agreement embodies a cost-based methodology -- the "TAPS Settlement Methodology" or "TSM" -- that serves as the basis for calculating the tariffs and the refund obligations of the TAPS owners through 1985, and provides a mechanism for determining the maximum tariffs that the TAPS owners may charge over the stipulated life of the pipeline.

The Settlement Agreement is the product of months of intense negotiation among the parties and represents a fair and reasonable compromise of their respective litigation positions. The parties entered into the negotiations with varying objectives. The agreement that emerged from these negotiations is designed to achieve,

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1/ See Settlement Agreement signed by the State of Alaska and ARCO Pipe Line Company dated February 8, 1985, Settlement Agreement signed by State and BP Pipelines Inc. dated April 24, 1985, and Technical Amendments to the ARCO and BPP Settlement Agreements dated April 29, 1985 (collectively, "Settlement Agreement"), each of which are attached to the Stipulation signed by State, DOJ, ARCO and BP dated April 30, 1985. Hereafter, all references to "Sections" are references to Sections in the ARCO Settlement Agreement.

2/ Because the Agreement between Alaska, ARCO and BP is intended to survive any possible extinction of FERC jurisdiction over TAPS, i.e., to be separately enforceable as a contract, DOJ did not become a direct signatory to the Agreement. However, by virtue of the Stipulation, DOJ regards itself as a party to the Agreement for purposes of settling the TAPS proceeding pending before the Commission, Docket No. OR78-1, and BP Pipelines Inc., Docket No. IS83-29-000, the separate proceeding covering BP's existing TAPS tariff.

It bears emphasis that the overall settlement in general, and the TSM in particular, have been crafted specifically for TAPS and the objectives of the parties. It is neither the intent nor the position of the parties to the settlement that the settlement methodology should be applied to any petroleum pipeline other than TAPS.[4/]

The purpose of this statement is to explain the various elements of the TAPS Settlement Agreement in the context in which they were negotiated -- not as independent terms, but as parts of an integrated whole. Section I summarizes the primary terms of the Settlement Agreement. Section II gives a brief history of TAPS and the proceedings before the Commission. Section III provides a detailed description of the settlement and the methodology it employs. Section IV describes the information provisions of the Agreement. Finally, Section V provides a preliminary overview of some of the reasons why Alaska and DOJ believe that the Settlement Offer is in the public interest and consistent with the Commission's statutory mandate.[5/]

4/ See Introduction to the Settlement Agreement.

5/ Alaska and DOJ believe that the current administrative record in the TAPS litigation provides an adequate basis for the Commission to approve the Settlement Offer under its Rules of Practice and Procedure. Nevertheless, if it is deemed necessary, the record will be supplemented.

FIG. 1: NORMAL HOME MORTGAGE

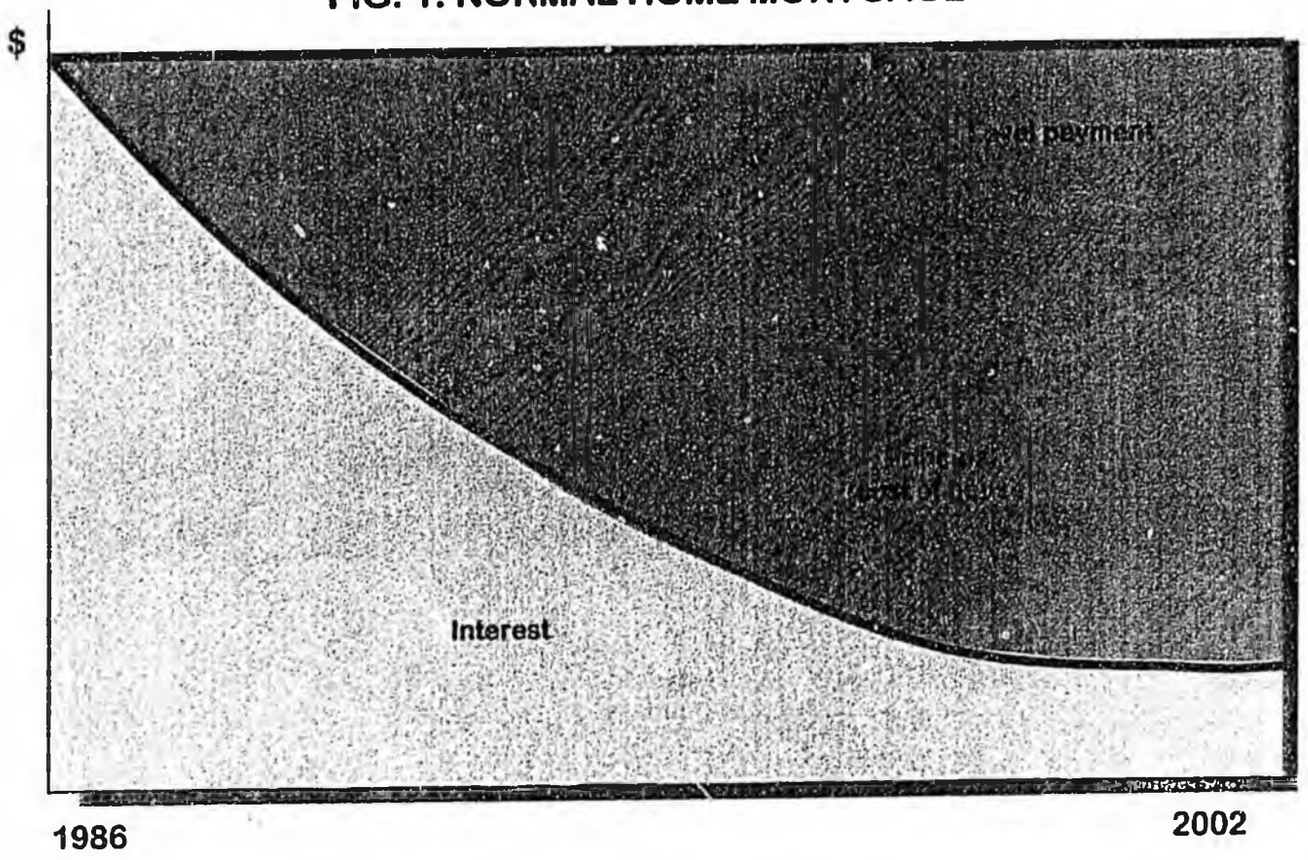
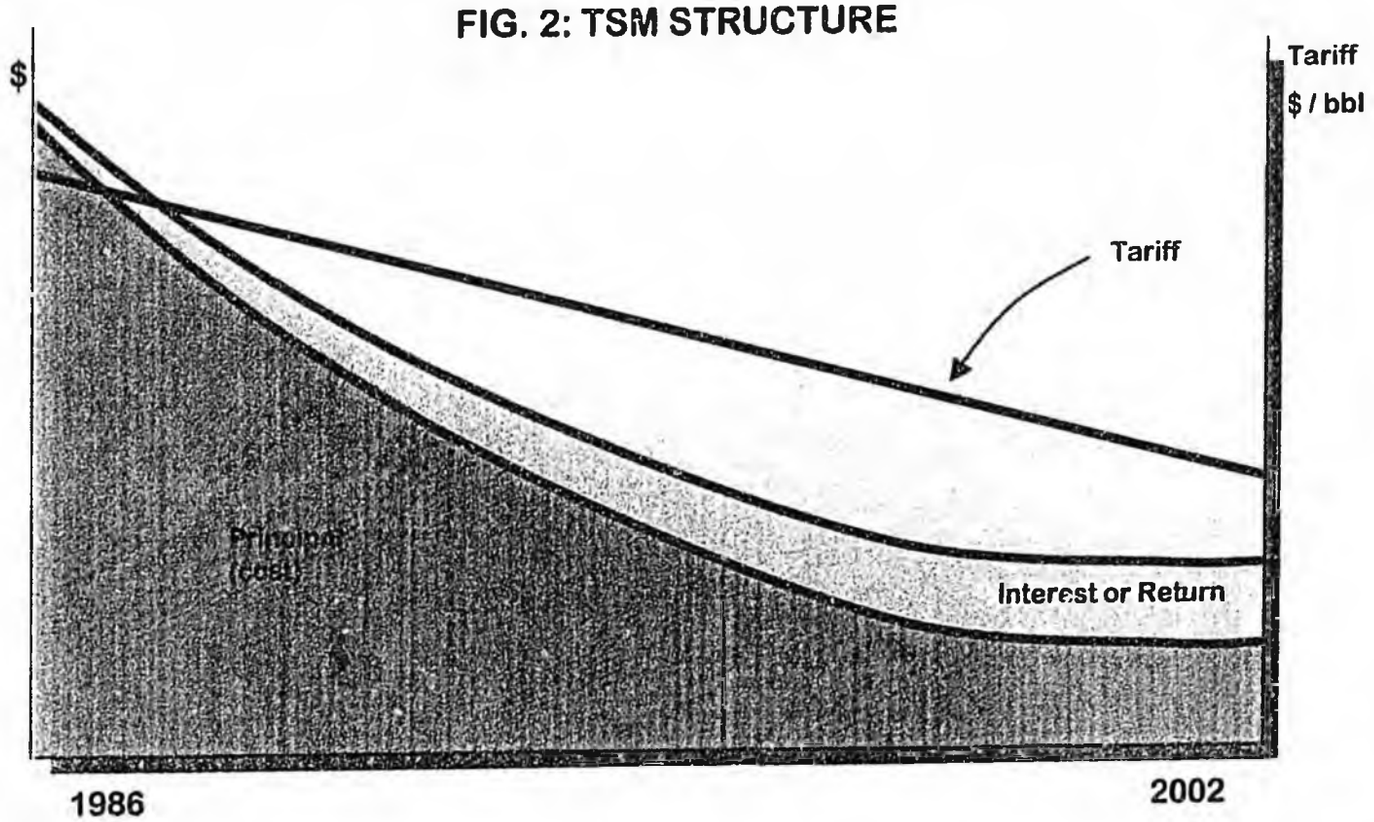


FIG. 2: TSM STRUCTURE



Anadarko Testimony Opposing HB 277

House Oil & Gas

Thursday, April 24, 2003, 3:15 p.m.

Mark Hanley, Alaska Public Affairs Manager, Anadarko Petroleum Corporation

Anadarko is one of the world's largest independent oil & gas exploration and production companies. At Anadarko we are explorers, using quality people and technology to find new reserves around the globe. We have a large acreage position in Alaska and are excited about the potential for oil and gas exploration in Alaska.

If you want to encourage Anadarko, other independents, and even majors who don't own part of the pipeline to come to Alaska and explore for oil and gas- then this bill is a bad idea. If you want to encourage the jobs and added value that comes from instate processing and instate use of Alaska's oil and gas- then this bill is a bad idea. If you want to help ensure that the state gets full value for its royalty oil and gas- then this bill is a bad idea.

Let's be clear what this bill is all about. The Regulatory Commission of Alaska found that the rates charged by TAPS carriers were excessively high -- by an average of 57% between 1997 and 2000. The settlement agreement between the state and the TAPS carriers insulates the TAPS carriers from claims the state could otherwise have made for the recovery of the billions of dollars the state potentially lost as a result. The agreement does not -- nor could it -- insulate the TAPS owners from overcharge claims other shippers were to make on the basis of the same rates the RCA found were excessive. But having shielded themselves by agreement from overcharge claims the State would otherwise have been able to pursue, the TAPS owners now want the legislature to insulate them against the legitimate claims of other shippers. We think that would be a mistake.

It's challenging enough exploring for oil and gas in Alaska, without having to worry about <u>not</u> being able to appeal excessive transportation charges for shipping your product down a pipeline. But that's what this bill would prohibit. Without public process, legislative review, regulatory

commission review or even participation by affected shippers, a deal could be negotiated with pipeline owners and the intrastate rates established by that deal could not be challenged.

This bill, without ever seeing the details of an agreement, predetermines that any negotiated pipeline tariff settlement, is in the public interest. It also predetermines, without ever actually seeing the shipping rates and rates of return and regardless of how high they might be, that those rates are "just and reasonable". The agreed upon rate or rate methodology cannot be challenged. Shippers who are not pipeline owners can't even appeal rates that are above those agreed to in the settlement.

While all companies want the best rate of return they can get, companies that ship oil & gas down pipelines and who also own those pipelines, have an incentive to shift as much profit as possible to the pipelines through high transportation rates. State royalties and taxes are based on well head value. Higher transportation costs lower the well head value and mean less paid in state royalties and taxes. This is one reason why pipelines are regulated and why they work on a cost plus type system, allowing them the opportunity to recover their costs, plus a reasonable rate of return. Pipelines are generally regulated to prevent artificially high transportation costs which could stymie competition in exploration.

Under this bill, if higher than reasonable rates were negotiated, the state would lose money and companies like Anadarko would be discouraged from Alaskan exploration, because those higher transportation costs would decrease the economics of our prospects. Contrary to the TAPS settlement agreement from 1986, this bill would prohibit the evaluation of rates to determine if they were excessive.

Now often, when reviewing legislation, you have to envision hypothetical situations to judge the potential effects of a bill. In this circumstance, we have a real life example to use as a case study and ironically, it seems that both the promoters of this bill and those of us who oppose it are using the same example to justify our positions. It's pretty clear that if this legislation had been in effect in 1986, Tesoro and Williams would not have been able to challenge the intrastate rates as excessive. The RCA would not have been able to review the rates and find that shippers were

paying 57% too much and that the state was losing billions of dollars in revenue because of high transportation costs. Despite the fact that a lot of things change during a 30 year deal (with no re-openers) no one would have been able to review the rates to see if they were excessive.

I suspect that you have seen the letter to Representative Tom Anderson where ConocoPhillips suggests that the Regulatory Commission of Alaska overturned an approved deal that was made back in 1986. "The Regulatory Commission of Alaska (RCA) has overturned a 1986 agreement with the State...". The agreement, "was approved by the Federal Energy Regulatory Commission as "fair, reasonable and in the public interest."" They go on to suggest that the 1986 agreement has not been honored, because this legislation will, "provide the confidence that an agreement with the State will be honored by all parties...".

A BP spokesman in a Dec. 31, 2002 Anchorage Daily News article stated, "The (method)under which the question arose was previously approved by the state of Alaska and FERC."

Inferences that the APUC (RCA) and/or FERC approved rates as reasonable, that the 1986 agreement was overturned by the RCA's consideration of a rate appeal, or that the 1986 agreement has not been honored, are incorrect.

The "rest of the story" is that at the time of the settlement, neither the Alaska Public Utilities Commission nor the Federal Energy Regulatory Commission ever reviewed and approved the rates as just and reasonable. Both the APUC and the FERC refused to impose the settlement terms on nonparticipating parties and both anticipated potential rate appeals in the future. The "deal" was that the rates could be challenged as excessive by someone other than the settling parties, and now ConocoPhillips and BP are trying to change the deal because they don't like the RCA ruling in response to a rate appeal.

Let me read a couple of statements from the recent RCA ruling. "Our predecessor agency accepted the Intrastate Settlement (the Settlement) because all affected parties supported it; the Commission did not decide that the Settlement produced just and reasonable rates." "The Alaska Public Utilities Commission (APUC) deferred the issue of whether TSM produced just and reasonable rates until a

shipper protested the rates." "Under the Alaska Pipeline Act, the Carriers have the burden of proving that the rates calculated and filed using TSM are just and reasonable."

Here are statements made by the TAPS Carriers in 1986 and 1987 in support of the offer of settlement. "The settling parties are not asking the Commission to approve at this time the rates to be charged in 1990 and later years. To the contrary, as the settling parties have repeatedly stated, TSM simply sets forth voluntary rate ceilings that the TAPS Carriers have agreed not to exceed in filing their future tariffs. If the Staff finds that the rates set under TSM in 1995 are too high, that issue can be addressed at that time." "If any non-signatory objects to the level of a future tariff rate, whether set within the confines of TSM or not, this Commission's processes remain available for the examination of that rate.

The following FERC statements are from the June 27, 1986 order approving the settlement. "In response to numerous allegations, we categorically state that our approval of this settlement is not a precedent as to future TAPS' rates." "The carriers cannot rely on the approved settlements to establish the justness of these filed rate changes, since the settlement rates were never adjudicated to be just and reasonable." "The burden of showing that the new rate is just and reasonable will be on the TAPS carriers,...". "...the Commission is not at this time imposing the terms of the Settlement Agreement on any nonsettling party."

It seems quite clear that the "deal" agreed to in 1986 allowed and anticipated future appeals to determine just and reasonable rates. Now, ConocoPhillips and BP want to change the deal and take away the ability to review intrastate rates that have been determined through a settlement agreement. This puts non-pipeline owner shippers at a disadvantage and could discourage exploration.

According to the RCA ruling, the maximum TAPS intrastate filed rates for the years 1997 through 2000 were too high by an average of 57 percent. The RCA also states that "the rates charged between 1977 and 1996 provided the TAPS Carriers with the opportunity to recover $9.9 billion more than the reasonable cost of providing service." If this is true, the state has potentially lost

billions of dollars in revenue because the high transportation costs reduce the well head value of the state's royalty oil.

Lower transportation costs will encourage new exploration in Alaska. The ability to appeal potentially excessive transportation rates discourages the filing of high rates and provides certainty to shippers that rates will be reasonable. Prohibiting the appeal of potentially excessive rates, as HB 277 would do, will discourage exploration.

Pipeline companies should have the opportunity to recover costs and earn a reasonable rate of return. They should not be entitled to excessive rates of return that diminish competition, discourage instate investment and cost the state money.

The state is about to begin negotiating a long term fiscal package on a proposed Alaska natural gas line and the TSM will also have to be eventually negotiated. Don't remove negotiating tools from the state's table before the negotiations even begin. And don't prohibit folks in the future from reviewing rates to ensure that they are just and reasonable.

Anadarko is strongly opposed to this bill. It's bad for explorers, it's bad for refiners, it's bad for the state and at a time when the goal is to encourage new companies to invest and explore in Alaska, this would be the wrong message to send.

Thank you for the opportunity to testify.

ConocoPhillips
Alaska, Inc.

Representative Tom Anderson
Chairman, House Labor and Commerce Committee
Alaska State Capitol, Room 432
Juneau, Alaska 99801

March 26, 2003

Dear Representative Anderson:

As we discussed last week, attached is suggested legislation that ConocoPhillips believes will address the significant problems that have resulted from recent orders issued by the Regulatory Commission of Alaska.

The Regulatory Commission of Alaska (RCA) has overturned a 1986 agreement with the State that ended 7 years of litigation, established TAPS tariff rate certainty for all shippers until 2011, and was approved by the Federal Energy Regulatory Commission as "fair, reasonable and in the public interest."

ConocoPhillips, other TAPS owners and the State have challenged the RCA decision in Superior Court. We are not asking the legislature to overturn that decision.

However, in order to encourage both existing and new companies to invest and have certainty about future pipeline tariffs, create a business environment that supports a fair return on any pipeline owners investment, and provide the confidence that an agreement with the State will be honored by all parties, ConocoPhillips supports the following changes to the Pipeline Act in AS 42.06:

- Clarify that the jurisdiction of the RCA over rates is limited to intrastate tariffs;
- Eliminate the RCA's jurisdiction over State Right-of-Way leases and clarify their authority over dismantlement, removal and restoration;
- Add a new section that ensures RCA support of rate methodologies agreed to in settlement agreements with the State;
- Change the applicable interest rate charged under RCA orders so that it conforms with the interest rate applied in other similar matters.

We look forward to working with you on this issue.

Sincerely,

Jerry Gallagher
Manager, Government Relations

TESTIMONY REGARDING WHY CHANGES TO THE PIPELINE ACT ARE NEEDED

Mr. Chairman, members of the Committee, thank you for this opportunity for ConocoPhillips to speak on this important issue. My name is Randal Buckendorf. I am an attorney in Anchorage for ConocoPhillips. I handle our environmental legal work and our pipelines legal work.

As Ms. Yaege has already explained, the changes we have advocated for are important for future certainty. You will hear testimony that this bill overturns recent RCA decisions. You will also hear a lot of testimony about the 1985 TAPS Settlement Agreement, how we are trying to advocate for the legislature through this bill to approve it, and also overturn a recent RCA ruling. This is all patently false and designed to raise red flags of dissension and controversy.

Instead, as Ms. Yaege as pointed out the bill is about regulatory clarity and certainty, and creating an atmosphere for the future where explorers like ConocoPhillips want to continue investing, exploring for new fields, and building pipelines. To that end, we have worked diligently in the last week at the request of the sponsor to work with other companies toward some compromise language. We remain willing to work with you and other interested parties on modifying the original bill.

With that in mind, I would like to walk you through the bill, what those suggested changes are designed to do and then we will make ourselves available for any questions you may have. However, I may not be able to speak to questions if they relate to the recent RCA ruling or other topics which are the subject of ongoing litigation. But, as I have already advised, this bill is not in any event overturning that ruling.

First, clarity of jurisdiction. Jurisdiction on pipelines in Alaska is shared. The Federal Energy Regulatory Commission (FERC) has jurisdiction over all of the oil produced in the state that ends up being placed on a tanker in Valdez and shipped to the West Coast.... this is slightly more than 90 percent of the oil transported on TAPS. The RCA on the other hand has jurisdiction over that oil that stays "in-state". It is this basic difference that creates the terminology "intrastate" (RCA regulated) and "interstate" (FERC regulated). The changes recommended in Sections 1 and 3 provide absolute clarity surrounding this intrastate jurisdiction and correct the jurisdictional creep that is evident in several recent orders.

Another area of jurisdictional overlap and discontinuity is between the RCA and the Department of Natural Resources, and potentially the RCA and the Federal Bureau of Land Management – for federal leases. The changes recommended in Sections 1 and 2 make it clear that it is the same agencies that granted our rights-of-way (and not the RCA) that oversee these leases and the requirements within those leases for dismantlement, removal, and restoration.

In contradiction to Chairman Harbour's statement in his letter from last week, the bill would not remove RCA authority to oversee money collected on intrastate rates for DR&R. What it does is clarify what jurisdiction the RCA properly has with respect to pipeline ROW leases. Pipeline ROW leases are contractual arrangements between each pipeline owner and either the Department of Natural Resources, the Bureau of Land Management, or in some instances a private party. Any implication that the RCA can attempt to insert itself into these leases almost like a signatory party when clearly they are not a party, is unacceptable both from a contractual, and regulatory point of view. Jurisdiction is the fundamental principle surrounding all regulatory agencies and it needs to be clear. HB 277 provides that clarity in Sections 1, 2 and 3.

Second, equal treatment and Section 6. Sometimes we are going to end up in litigation. A pipeline act refund order is a "judgment" issued by an administrative agency as part of an administrative proceeding and it is treated as a judgment by the Alaska Supreme Courts rules of Appellate Procedure. The same interest rate that applies to judgments under the Pipeline Act has always been the same interest rate that applied to other judgments. That was the legislative intent in 1978 when it wrote this section of the act and we believe that the 1997 tort reform amendments also changed the applicable interest rate on Pipeline Act judgments. However, it is being argued that was not the case. The amendment in Section 6 makes it clear that the legislature did not intend to single out pipeline companies from every other business entity. As Chair Harbour pointed out, this is a decision the legislature can and should make. We believe that at a minimum it needs to be changed point forward. If however, the legislature agrees with us that the change was intended to be made in 1997 then the legislature can also decide that this clarification can be made retroactively back to the effective date of the 1997 amendments. Section 9 would do that.

Third, retroactive ratemaking and Section 7. It is a common principle of regulated utilities that an agency like the commission cannot bypass the rule against retroactive ratemaking. That rule is a fundamental aspect of regulated utility law and it is simply stated that an agency cannot retroactively apply a requirement for periods prior in time to when a complaint, protest, or commission action initiated the investigation or hearing that led up to that requirement. Section 7 was intended to make

this clear. However, just as Chair Harbour pointed out in his testimony and sectional analysis, our suggested change to this section was broadened into something that was not intended. Essentially we suggested a change to this section that would make it clear that an order setting rates under this section shall not affect rates in effect before the date of the protest, complaint, or commission action that initiated the investigation or hearing. We look forward to working with you and the other parties, including the administration and the commission, to modify this section.

Finally, business certainty. As we have already explained, we are neither asking you to overturn the recent RCA decision on TAPS rates nor to legislatively validate the TAPS settlement agreement itself. I am confident though that the testimony that will soon follow would have you believe Section 5 would do just that. That is incorrect. Section 5 does not look at current agreements. It looks only to the future. The TAPS settlement agreement will expire in a few years. That agreement requires us to begin negotiation of a new agreement with the administration. Section 5 creates certainty for doing that.

When the State of Alaska through the Office of the Attorney General acts, it acts in the best interests of the state and the best interests of the public. The Alaska Supreme Court recognizes this principle, the Governor recently recognized it in Executive Order No. 111 and the concurrent amendment to AS 44.23.020, and so should the legislature.

Notwithstanding these valid reasons for section 5, we have no objection to removing it. We do hope that we will be able to work with you and the other parties to somehow recognize this principle, either now or in the future.

Thank you again for your time. We are pleased to try and answer any questions you may have about the bill itself. Again, because we are in litigation we may not be able to address certain questions you may have.