3/5/07 PRESENTA-TION: FERC

Presentation
to
House Resources Committee

Overview of TAPS Litigation to Establish Just and Reasonable Rates

March 5, 2007, 1:00 p.m.

OVERVIEW

- THE WEALTH OF ALASKA IS IN ITS OIL AND GAS RESOURCES. TH[illegible] RESOURCES MUST BE TRANSPORTED TO THE MARKET THROUG[illegible] PIPELINES.

- PROPER REGULATION OF THESE MONOPLY PIPELINES MUST CO[illegible] BASIC FACTORS: (1) FAIR ACCESS AND (2) JUST AND REASONA[illegible]

- FAIR ACCESS MEANS SHIPPERS ARE PROVIDED A FAIR OPPORTU[illegible] TRANSPORT OIL AND GAS THROUGH THE PIPELINE.

- JUST AND REASONABLE RATES MEAN SHIPPERS ARE REQUI[illegible] BASED ON THE COSTS OF PROVIDING SERVICE. SPECIFIC[illegible] REASONABLE RATES PERMIT THE CARRIER AN OPPORTU[illegible] (1) ITS OPERATING COSTS, (2) ITS ORIGINAL INVESTMENT, A[illegible] REASONABLE RETURN ON ITS INVESTMENT THAT IS NOT YET RECOVERED.

- FAIR ACCESS AT JUST AND REASONABLE RATES WILL OPTIM[illegible] DEVELOPMENT OF OUR OIL AND GAS RESOURCES, PARTIC[illegible] RESOURCES FACING MARGINAL ECONOMICS, (2) THE STATE [illegible] ROYALITY AND SEVERENCE TAXES, AND (3) VALUE-ADDED MANUFAC[illegible] AND JOBS FOR ALASKANS.

Brena, Bell & Clarkson

THE TAPS SETTLEMENT METHODOLOGY (TSM)

- THE TSM IS THE METHODOLOGY THE T... OWNERS AND STATE OF ALASKA USED I... 1985 SETTLEMENT TO DETERMINE CEILI... FOR TAPS
- THE TSM DOES NOT PRODUCE JUST AN... REASONABLE RATES FOR SEVERAL ...
  - EXCESSIVE RETURNS
  - ALLOWANCE PER BARREL
  - RATES ARE BASED ON SUBJECTIVE PROJECTI...
  - DEPRECIATION BASED ON THE WRONG ECO...
  - TRUE-UP OF TOTAL REVENUE
  - FAULTY JURISDICTIONAL SEPARATIONS

TAPS---AN EXAMPLE OF [illegible] GETTING TRANSPORTATION RATES [illegible] RIGHT

- THE TAPS OWNERS HAVE COLLECTED $60 BILLI[illegible] TRANSPORTATION RATES THROUGH 2004, EVEN [illegible] THEY ONLY INVESTED $10 BILLION TO BUILD TAP[illegible] HAVE SPENT ONLY $15 BILLION TO OPERATE TA[illegible] THROUGH 2004.

- THE TAPS OWNERS HAVE COLLECTED $35 B[illegible] RETURN AND TAXES THROUGH 2004 ($60 BIL[illegible] LESS $10 BILLION INVESTED AND LESS $15 BILLION [illegible] OPERATE) WHICH IS $18 BILLION MORE THAN JUST [illegible] REASONABLE RATES ESTABLISHED UNDER A [illegible] DEPRECIATED ORIGINAL COST METHODOLOGY [illegible] $14 BILLION MORE THAN UNDER A TRENDED ORIGI[illegible] COST METHODOLOGY (TOC).

TSM-Overcollections 1977-2004
($Millions)

Line No.	Description	TSM	DOC	
[illegible]	Revenue Received/Requirement	$60,091.10	$41,6[illegible].54	
[illegible]	Operating Expenses	($15,055.57)	($15,055.57)	
[illegible]	Gross Plant & AFUDC	($10,406.20)	($10,40[illegible].2[illegible])	
4	Return & Income Tax Allowance	$34,629.33	$16,2[illegible]	
5	Excess Return		$18,424.56	$1[illegible],549.9[illegible]

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TSM-TOC Comparison
Annual 2006 Revenue Requirements
($Millions)

Line No.	Description	TSM	[illegible]	[illegible]
1	Operating Expenses	$580.39	[illegible]	[illegible]
2	Depreciation Expense	$58.55	[illegible]	[illegible]
3	Amortization of Deferred Earnings	$40.03	[illegible]	[illegible]
4	Amortization of AFUDC	$5.71	[illegible]	[illegible]
5	DR&R Allowance	$2.25	[illegible]	[illegible]
6	Return Allowance			
7	ROE/TOC & A[illegible]B/TSM	$220.26	[illegible]	[illegible]
8	Interest/TOC & Return on Rate Base/TSM	$24.00	[illegible]	($10[illegible]
9	Total Return Allowance	$244.26	[illegible]	($190[illegible]
10	Income Tax Allowance	$198.60	$22.1[illegible]	[illegible]
11	Non-Transportation Revenues	($0.25)	($0.2[illegible]	[illegible]
12	Composite Net Carryover	$68.25	[illegible]	[illegible]
13	Total Revenue Requirement	$1,197.79	$6[illegible]7.32	[illegible]
14	Composite System Barrels	313.342	326.79[illegible]	[illegible]
15	Composite Rate	$3.82	$1.98	[illegible]
16	Valdez Interstate Rate ($/Bbl)	$3.95	$2.0[illegible]	[illegible]

Comparison of Anadarko/Tesoro's Revised [illegible] Revised DOC Cases and TAPS Carriers' 154-[illegible]

Total 2006 Revenue Requirements and Rates ($ Millions)

Line No.	Description	Revised A/T 154-B
1	Operating Expenses*	$559.65
2	Depreciation Expense	$13.48
3	Amortization of Deferred Earnings	$7.13
4	Amortization of AFUDC	$0.86
5	DR&R Allowance	$0.00
6	Return Allowance	
7	Return on Equity	$30.58
8	Interest	$13.77
9	Total Return Allowance	$44.34
10	Income Tax Allowance	$22.13
11	Non-Transportation Revenues	($0.27)
[illegible]	Total Revenue Requirement	$647.32
[illegible]	Composite System Barrels (Millions)	326.795
[illegible]	Composite Rate ($/Bbl)	$1.98
[illegible]	Valdez Interstate Rate ($/Bbl)	$2.04

Differences Between TAPS Carriers' 2006 154-B Proxy [illegible] and Rate and Anadarko/Tesoro's Revised 154-B Revenue Require[illegible] ($Millions)

	Revised Revenues
TAPS Carriers' 154-B	$1,751.18
Less Revenue from Deferred Earnings	($580.00)
Less Revenue from Starting Rate Base	($95.02)
Less Revenue from Accelerated Portion of Depreciation and Other	($428.23)
Anadarko/Tesoro's 154-B	$647.32

TSM Rates Filed by TAPS Ca[illegible]

CARRIER	2004	2005	[illegible]
BP Pipelines (Alaska) Inc.	$3.01	$3.86	[illegible]
ConocoPhillips Transportation Alaska, Inc.	$3.09	$3.52	[illegible]
ExxonMobil Pipeline Company	$3.07	[illegible]	[illegible]
Koch Alaska Pipeline Company, LLC	N/A	$3.97	$4.41
[illegible] Pipeline Company	$3.00	$3.5[illegible]	[illegible]

TAPS—AN EXAMPLE OF NOT GE... DISMANTLEMENT, REMOVAL & RESTOR... RIGHT

- THE TAPS OWNERS HAVE COLLECTED AND EA... BILLION IN DR&R THROUGH 2004, EVEN THOUG... ESTIMATE OF THE COSTS OF DR&R IS $2.6 BILLI...
- THE TAPS OWNERS HAVE COLLECTED AND EARN... BILLION MORE THAN IS NECESSARY TO PERFO... TAPS
- THE TAPS OWNERS ARE REFUSING TO ACCOUNT FOR T... DR&R COLLECTIONS AND EARNINGS
- THE TAPS OWNERS ARE REFUSING TO ACKNOWLEDGE... THEIR DR&R OVERCOLLECTIONS AND EARNINGS AR... REFUNDABLE IF NOT USED FOR DR&R

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INDICATORS OF A [illegible] PIPELINE DEAL

- PROCESS WAS NOT TRANSPARENT AND COMPETITIVE
- RATES ARE NOT BASED ON THE COSTS OF PROVIDING SERVICE
- ACCESS TO EXISTING AND EXPANSION CAPACITY IS LIMITED
- MAJOR RATE AND ACCESS ISSUES ARE NOT RESOLVED
- THE STATE OF ALASKA'S INHERENT POWERS ARE RESTRICTED
- NO PROTECTIONS AGAINST SELF-DEALING, AFFILIATED TRANSACT[illegible]
- LINKAGE TO NONTRANSPORTATION MATTERS
- ECONOMIC ASSUMPTIONS ARE UNKNOWABLE WITHOUT REOPENERS [illegible]
- UNNECESSARILY COMPLEX
- CERTAINTY IS CONFUSED WITH PREDICTABILITY

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Historical and Current State Revenue bss Qantified

Difference Between RCA's 2002 TAPS Tariff Order And State's 1985 Pipeline Tariff Agreement Costs State More Than $400 per Minute

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A Report to the *Alaska Budget Report*
by
Richard A. Fineberg *

February 28, 2007

Executive Summary

The state loses more than $400 in revenue every minute due to excessive charges on the Trans-Alaska Pipeline System (TAPS), according to an analysis of current TAPS shipping charges, or tariffs. The state's ongoing TAPS revenue hemorrhage – now in its 31st year – totals more than $3.0 billion (approximately $4.5 billion in today's dollars).

The estimated present and historical state revenue losses reported here are based on comparison between the tariffs the TAPS owners charge for shipping oil on the 800-mile pipeline that connects Prudhoe Bay with Valdez and the much lower TAPS tariffs ordered since 2002 by the Regulatory Commission of Alaska (RCA), a quasi-independent state agency whose duties include regulation of in-state pipeline tariffs.

Experience demonstrates that the retroactive charges on both tariff refunds to shippers and the resulting royalty and production tax refunds to the state grow increasingly difficult to collect as time passes. Unless TAPS tariff overcharges are corrected in a timely manner, a major portion of the tax incentives offered at state expense will continue to be transferred directly into the hands of the TAPS owners, vitiating the intended benefits of those tax incentives.

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* The author is the principal investigator for Research Associates of Ester. He served as a senior advisor to the governor on oil and gas policy between 1986 and 1989, focusing on issues including oil and gas development, revenue collection, litigation, forecasting and environmental protection. Since that time he has prepared numerous reports on Alaska petroleum development issues while serving as a consultant to parties that include environmental groups, non-government organizations, government agencies and private investors. Ho prepared and presented testimony in the Regulatory Commission of Alaska's 2001 hearing on the Trans-Alaska Pipeline System tariffs as the RCA Public Advocacy Section Expert Witness. Many of his reports can be accessed at http://www.finebergresearch.com.

$213 million, which equates to a loss of more than $404 per minute, would fund the governor's proposed unspecified operating budget cuts ($150 million), plus more than $60 million in proposed supplemental bills for the following items:

- Alaska Marine Highway operations ($21 million);
- disaster relief ($18 million);
- Department of Corrections ($13 million); and
- Department of Law cost overruns on gas pipeline negotiations ($8.5 million).[2]

Three transnational oil companies – British Petroleum, ConocoPhillips and ExxonMobil – own more than 95 percent of TAPS and control a similar share of North Slope production.[3] For this reason, a large portion of TAPS tariff overcharges are internal company transfer payments; from a company cash-flow standpoint, these excess tariffs are a matter of paperwork; they aren't real. But the resulting losses to the state are. Transportation charges are subtracted from the price of oil to determine the basis for royalty and production tax payments to the state.[4] For this reason, the state currently loses more than twenty cents on every dollar charged for pipeline shipping.[5]

Assuring that tariffs are "just and reasonable" – RCA's mandate under AS 42.06 – is important for another reason: Unlike the TAPS owners, who simply transfer the most overcharges from their production unit to their pipeline subsidiary, independent producers or shippers must pay those charges out of pocket. Consequently, TAPS overcharges can put a serious damper on North Slope development. This chill is particularly important because the state is offering inducements to independent companies in hopes that they will explore for the yet-undiscovered natural gas necessary to assure the economic viability of a natural gas pipeline from Prudhoe Bay to the Lower-48.

A simplified annual reckoning of historical state losses due to TAPS tariff overcharges is presented in Figure 1.

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[2] State supplemental budget figures taken from: Anne Sutton (Associated Press), " Palin seeks to add funds to current budget -$144 MILLION: Gas line plans and school rebuilding fed a supplemental request," *Anchorage Daily News*, Feb. 15, 2007.

[3] For TAPS and North Slope production ownership percentages, see Worksheet 2.

[4] For brief discussion and description of TAPS tariffs, see: Richard A. Fineberg, *The Profitability and Economic Viability of Alaska North Slope and Associated Pipeline Operations*, Prince William Sound Regional Citizens' Advisory Council (April 27, 2005), pp. 35-42; and *The Emperor's New Hose: How Big Oil Gets Rich Gambling with Alaska's Environment*, Alaska Forum for Environmental Responsibility (June 2002), Ch. 5.

[5] See Worksheet 4 for the estimating factors adopted for this analysis. Note: In its 1978 ruling that the state would be entitled to collect refunds in the event of TAPS overcharges, the U.S. Supreme Court cited the state's claim that every dollar in tariff excess charges would reduce state revenue by $0.23. (*Trans Alaska Pipeline Rate Cases (Mobil Alaska Pipeline Company, et al. v. United States, et al.*,1978 (436 US 631 [56 L Ed 2d 591]), fn. 6).

Figure 1

Estimated State Revenue Losses Under TAPS Settlement Methodology, 1977 - 2007

These data, which reflect simplified assumptions and methods for analyzing publicly available information, should be regarded as preliminary estimates. The author believes the conservative estimating factors used here are likely to understate actual state losses.

(1) Year	(2) GDP Implicit Price Deflator (Index)	(3) Inflation (%)	(4) Alaska North Slope Production (Million barrels)	(5) Estimated State Revenue Loss Due to TSM TAPS Tariff Excess over RCA 2002 Decision and Order ($ Millions) (Nominal $)	(6) (2007 $)
1977	42.3300	4.2%	96.909	$16.81	$47.22
1978	45.1800	6.7%	394.990	$68.51	$180.33
1979	48.8200	8.1%	465.532	$80.75	$196.69
1980	53.1000	8.8%	550.695	$95.52	$213.92
1981	58.3000	9.8%	549.108	$95.24	$194.28
1982	62.2900	6.8%	585.878	$101.62	$194.01
1983	65.0400	4.4%	594.481	$103.11	$188.53
1984	67.4400	3.7%	599.897	$104.05	$183.48
1985	69.9300	3.7%	648.118	$112.42	$191.17
1986	71.2500	1.9%	658.918	$114.29	$190.76
1987	73.1100	2.6%	709.333	$123.03	$200.13
1988	75.4100	3.1%	745.015	$129.22	$203.78
1989	78.3400	3.9%	677.393	$117.49	$178.36
1990	81.2500	3.7%	641.937	$111.34	$162.97
1991	84.3000	3.8%	654.257	$113.48	$160.08
1992	86.4200	2.5%	630.514	$109.36	$150.49
1993	88.3800	2.3%	579.887	$100.58	$135.34
1994	90.2800	2.1%	568.990	$98.69	$130.00
1995	92.1800	2.1%	547.080	$94.89	$122.42
1996	93.9500	1.9%	516.461	$89.58	$113.39
1997	95.5900	1.7%	492.800	$75.10	$93.43
1998	96.7500	1.2%	448.500	$55.67	$68.42
1999	98.0200	1.3%	405.200	$61.62	$74.76
2000	100.0000	2.0%	371.100	$65.31	$77.67
2001	102.3600	2.4%	362.800	$79.10	$91.90
2002	104.3200	1.9%	369.700	$99.12	$112.99
2003	106.4300	2.0%	362.700	$92.82	$103.71
2004	109.1800	2.6%	343.000	$78.89	$85.93
2005	112.5100	3.1%	323.755	$113.96	$120.45
2006	115.9800	3.1%	292.456	$139.21	$142.74
2007	118.9200	2.5%	276.488	$212.90	$212.90
			Total State Loss: (Million $)	**$3,053.70** Nominal $	**$4,522.23** 2007 $

Notes

In its 2002 decision and order requiring TAPS owners to reduce intrastate TAPS tariffs (shipping charges) for the 1997-2000 period, the Regulatory Commission of Alaska (RCA) reported that between1977 and 1996 TAPS owners overcharged shippers by $9.9 billion[1]. Because four companies own almost 96% of TAPS and a similar share of the oil they transport, much of this sum represented internal transfer payments. But transportation charges are also subtracted from the state tax and royalty base. For this reason, excess tariffs on TAPS have cost the state more than $3 billion since 1977 (more than $4.5 billion in 2007 $), as shown in Columns (5) and (6) of this figure[2].

1977 - 1996: To estimate state revenue lost during this period, $9.9 billion is divided into 20 equal shares of $99 million per year, then pro-rated to reflect that year's share of total production. For example, 1977 North Slope production of 96.909 million barrels (shown in Col. [4]) was 16.978 percent of the 20-year average (570.77 million barrels). Therefore, the state's loss for this period is conservatively estimated in Col. (5) at $16.808 million.[3] To convert this loss to current dollars, the GDP Implicit Price Deflator, shown in Col. (2), is used[4]; results are shown in Col. (6).

1997 - 2005: For the 1997-2005 period, the 20 percent factor is applied to total TAPS throughput, then multiplied by the per-barrel difference between the tariff that the RCA has determined to be just and reasonable ($1.96 per barrel) and the weighted average TSM tariffs for each year[5].

2006 - 2007: The first three months of 2006 are calculated using the method described above; the final nine months of 2006 are estimated using the method spelled out for 2007 in Worksheets 1 through 9 at the back of this report. Under the Petroleum Profits Tax (PPT), the combined royalty and production tax share is estimated to increase to 25.6% of tariff charges.

(See notes on following page.)

Figure 1 Estimated State Revenue Losses Under TAPS Settlement Methodology, 1977 - 2007

Notes:

1. 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* (Order P-97-4[151] / P-97-7[110]), Nov. 26, 2002, p. 8.

2. In its 1978 ruling that the state would be entitled to collect refunds in the event of TAPS overcharges, the U.S. Supreme Court cited the state's claim that every dollar in tariff excess charges would reduce state revenue by $0.23. (*Trans Alaska Pipeline Rate Cases (Mobil Alaska Pipeline Company, et al. v. United States, et al.*,1978 (436 US 631 [56 L Ed 2d 591]), fn. 6).

3. $9.9 billion / 20 years = $495,000,000 per year; $495,000,000 * 0.20 = $99,000,000 (annual share before prorating). $99,000,000 * 96.909 / 570.770 = $16.808 million (estimated state loss for 1977).

4. U.S. Office of Management and Budget, *The Budget for Fiscal Year 2008, Historical Tables*, "Gross Domestic Product and Deflators Used in the Historical Tables: 1940-2012" (February 2007), pp. 192-193.

5. Throughput and tariff estimates were drawn from Alaska Department of Revenue reports and published tariff data. To calculate 1997-2007 overcharges, the Regulatory Commission of Alaska line-wide tariff of $1.96 per barrel was subtracted from the following estimated annual weighted average TAPS tariffs:

Year	Estimated TAPS Tariff
1997	$2.72 / bbl.
1998	$2.58 / bbl.
1999	$2.72 / bbl.
2000	$2.84 / bbl.
2001	$3.05 / bbl.
2002	$3.30 / bbl.
2003	$3.24 / bbl.
2004	$3.11 / bbl.
2005	$3.72 / bbl.
2006	$3.98 / bbl.
2007	$5.10 / bbl.

It should be noted that variations between actual shipping rates for a given year and published tariff data can result from factors such as the following: Adjustments in the reported tariff to provide increased (or decreased) shipping revenue collections to account for prior-year shortfall or excess collections resulting from factors such as the variances between filed tariff (forecast) throughput and actual shipments; reported tariffs do not reveal factors such as revisions during the year or discounts; data necessary to account for oil removed from the line prior to Valdez (such as North Pole shipments) may not be readily available.

(Research Associates, February 2007)

II. Background

The RCA complaint against the TAPS owners was brought by Tesoro Alaska Petroleum Company in 1997. Tesoro, which refines and markets oil on the West Coast and in Alaska but does not have an ownership stake in North Slope fields or in TAPS, was joined by the Williams Alaska Petroleum Company, which then operated the North Pole refinery, and the commission's Public Advocacy Section. The state sided with the TAPS owners in urging the RCA to reject the shippers' complaint that they were unjustly penalized by excessive tariffs under TSM. During the proceeding the state argued, among other things, that the TSM produced equitable results and provided ratemaking stability.

The RCA's November 2002 tariff ruling ordered the TAPS owners to reduce TAPS tariffs to $1.96 and pay refunds to the shippers on all overcharges since 1997. The lower rate, the commission held, would provide the TAPS owners sufficient revenue to pay all expenses and earn a reasonable profit on their pipeline expenditures. The 168-page decision and order – which was backed by more than 300 pages of endnotes supporting exhibits that summarized more than 75,000 pages of documents generated during the five-year proceeding – also found that between 1977 and 1996 the TAPS owners had collected $9.9 billion too much in TAPS tariffs. But the commission determined that the earlier overcharges were not subject to refund.[6]

While they ask the courts to reverse the RCA's 2002 order, the TAPS owners continue to raise the tariff in annual filings. The latest TAPS rate hike raises TAPS tariff charged by the owners to $5.10 per barrel at FERC, compared to a TSM tariff $2.72 per barrel in 1997, when the case began.[7] Since 2002, the RCA has upheld its initial tariff and consistently rejected the TAPS owners' tariff increases.[8] But experience demonstrates that the retroactive payments to both tariff refunds to shippers and the resulting royalty and production tax refunds to the state grow increasingly difficult to collect as time passes.

In January 2006 the state Superior Court issued a strongly worded decision upholding the RCA's order "in all respects," rejecting the TAPS owners' challenge to the commission's orders. The TAPS owners and the RCA's

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[6] 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 Nos. P-97-4 and P-97-7, Order P-97-4[151] / P-97-7[110]), Nov. 26, 2002.

[7] Estimated annual TAPS tariffs for 1997 through 2007 are shown at footnote 5 of Figure 1, above.

[8] See, for example: Regulatory Commission of Alaska, *Order Rejecting The TAPS Carriers' 2001-2003 TSM Intrastate Filings, Rejecting the TAPS Carriers' Post-2000 Revenue Requirement and Rate Filings, Establishing Permanent Post-2000 Intrastate TAPS Rates, Requiring Refunds, Ordering Release of Escrowed Funds, Letters of Credit, and Bonds; Approving Filings and Affirming Electronic Rulings, 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings, and Outlining Phase II Issues* (Docket P-03-4, Order P-03-4[34]), June 10, 2004; and *Order Rejecting 2006 TAPS Settlement Methodology Rates* (Docket P-06-1, Order No. 1), Dec. 16, 2005.

attorneys have a March 13 date with the state Supreme Court for oral arguments. While the litigation continues, thc ordered tariff reductions and refunds ordered by the commission for in-state shipments on TAPS have been put on hold.[9]

Nearly 90 per cent of the oil shipped on TAPS goes to the Lower-48 and therefore falls under the jurisdiction of the Federal Energy Regulatory Commission (FERC).[10] TAPS tariffs have been under attack at the federal agency since 2004, when shippers Tesoro and Anadarko – the largest independent producer on the North Slope – protested TAPS tariffs. The shippers were joined by the Department of Law, which is challenging implementation of the TSM without challenging the methodology itself.

On Feb. 16, 2007, the FERC staff filed a 111-page brief that sided with TAPS shippers Anadarko and Tesoro and the state in seeking reduced TAPS tariffs. The report castigated the TAPS owners for trying to defend their filed tariffs with what the staff described as generalities, faulty reasoning and even arguments the commission staff found "silly." In its report to the FERC commissioners, the federal agency staff found no basis to question the RCA's investigation, which it described as "extensive, "exhaustive" and "comprehensive."[11]

While the ongoing litigation over tariffs unfolds at the RCA and at FERC, questions regarding recovery of royalty and production taxes underpaid due to TAPS tariff overcharges – remais in limbo. Oil and gas administration is compartmentalized, and royalty and tax issues are litigated in entirely separate administrative processes,

III. Comments

Sometimes failure to identify the right question can prevented policy makers from seeing – and, therefore, from resolving – fundamental public policy problem. By way of example: when asked to quantify losses attributable to the $5.10 per barrel tariff filed at FERC in December, a senior economist at the Department of Revenue compared the new, TSM-generated tariff to the old TSM tariff, rather than to the RCA benchmark. The result was a widely circulated press report that estimated the state's revenue loss for the current state fiscal year to be less than half the amount estimated here for calendar-year 2007.[12]

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[9] "Decision and Order," Jan. 18. 2006, in Amerada Hess Pipeline Corporation, et al. vs. Regulatory Commission of Alaska (Case No. 3AN-02-13511 CI [Alaska Superior Court, 3rd Judicial District]), Jan. 18, 2006.

[10] See Worksheet 3.

[11] " Initial Brief of the Commission Trial Staff," in State of Alaska v. BP Pipelines (Alaska), et al. (Docket No. ORO5-2-001), Anadarko Petroleum Corporation v. TAPS Carriers (Docket Nos. ORO5-3-001 and ORO6-2-001), Federal Energy Regulatory Commission, Feb. 16, 2007, pp. 6, 27, 97.

[12] The Alaska Department of Revenue estimated a fiscal year 2007 loss of $102 million due to higher tariffs. See: Sam Bishop, "Pipeline rates could cost state millions," *Fairbanks Daily News-Miner*, Jan. 5, 2007; and Associated Press, "Higher tariffs could cost state millions – Hit on state revenues from tariffs about 50%

At critical junctures during introduction and legislative review of the TSM in 1985 and at several points during the settlement's subsequent implementation, discussion of the public policy implications and execution of this important element of petroleum development policy has suffered from the Department of Law's failure to provide key information and a tendency to give short shrift to questions and criticism of the 1985 settlement it negotiated with the TAPS owners.[13] With this background in mind, it should be noted that in the eight years since the governor stated his intention (later recanted) to make lower

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higher under new tax, but overall new tax will still bring in more revenue than old," *Petroleum News*, Jan. 14, 2007 (accessed Jan. 14, 2007 at http://www.petroleumnews.com/pntruncate/357117363.shtml). Both articles stated that the owners were increasing their tariff for CY 2007 by $1.14 per barrel over the prior year. Neither article mentioned that the prior-year tariff increases had been rejected by the RCA in decisions upheld by the Superior Court, or that the prior-year tariffs were also being challenged at FERC. The ADOR estimate of revenue lost is invalid because ADOR is comparing the filed 2007 tariff to the 2006 tariff, which was, in turn, already more than a dollar higher than the RCA order tariff. (Based on information provided by ADOR personnel, it appears that the agency's methodology, if applied to a comparison between current tariffs and the RCA tariff, would produce a significantly higher figure for current lost revenue than estimated here. However, reconciling estimating differences was beyond the limited scope of this report.)

[13] Two of the low points from this history will be briefly summarized here:

As part of a briefing the Department of Law prepared for a joint session of the House Oil and Gas and Senate Resource Committees in March 1985, the Department of Law implied the U.S. Supreme Court would not support a state quest for refunds, when that issue had already been litigated before the Supreme Court, resulting in a unanimous 1978 decision that, in the event of overcharges, the state would, in fact, be entitled to pursue them (case cited in Footnote 4, above). A list of key events in the history of pipeline ratemaking provided by the Department of Law omitted neglected to mention that decision.

Later in 1985, as the settlement neared its final stage, the governor was provided incorrect data on the benefits of settlement versus continued litigation. When the error was discovered, the Department of Law gathered and destroyed original copies of the erroneous document (in apparent violation of state law). Months later, with the substitute document in place, department officials denied that they had altered the document.

(Full documentation for both of the preceding points is found in The 1985 TAPS Tariff Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers [supplemental report to "Oil and Gas Revenue Disputes"]. Alaska State Legislature, February 1990.)

In 1997, when this writer published a report on TAPS antitrust issues for Oilwatch Alaska, the Attorney General dismissed the report in a 14-page letter that:

- mis-stated the central thesis of the report in at least two respects (then proceeded to respond to those straw-man arguments, rather than the substance of the report);
- questioned the veracity of a cited published statement by the chief executive of a North Slope oil company that one reason that his firm traded its North Slope properties to BP and left Alaska was that "all the value of that property was taken away from us in the pipeline tariffs" (when the statement was part of a published magazine interview the company itself distributed); and
- categorically denied the charge that the state had overlooked antitrust problems and claimed to be actively involved whenever that possibility might exist. (But the Attorney General was unaware that an independent tanker operator had filed suits in federal and state courts in Juneau alleging that the Alyeska Pipeline Service Co. had illegally denied its tanker access to Valdez, in violation of federal antitrust and state contract law; the state case was tried in Juneau the following year; theTAPS owners settled out of court for a sum reported to exceed $8 million; as part of the settlement, the companion antitrust case was dropped.)

See: Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope*, Oilwatch Alaska (October 1997); Brian O'Donoghue, "Suit Alleges antitrust violations by Alyeska," Fairbanks Daily News-Miner, Nov. 30, 1997, p. 1; and "Memorandum of Decision and Order," in Maritime Endeavor Associates, L.P., vs. Alyeska Pipeline Service Co. (Case No. 1JU-95-1141 CI [Alaska Superior Court, 1st Judicial District]), Sept. 30, 1998.

TAPS tariffs a condition of BP's proposed merger with ARCO in 1999, TAPS tariffs have nearly doubled under TSM, while the state lost over $700 million dollars due to TAPS tariff overcharges between 1999 and 2006. It has been three years since the Department of Law entered into a memorandum of understanding with the TAPS owners to renegotiate the TSM. During this period, the state lost an estimated $330 million.[14] Perhaps more significantly, throughout this entire period the state has failed to correct the significant barrier to North Slope development posed by TAPS tariffs that even the Department of Law now acknowledges are excessive. The documented history of the state's failure to correct its course on TAPS tariffs in a timely manner prompts the following questions: Could an aggressive attempt to alter the state's tariff policy in a timely manner have saved hundreds of millions – perhaps billions – of dollars while promoting instead of inhibiting development? What factors caused the Department of Law to be so slow to recognize – and, more recently, to attempt to redress – the shortcomings of the settlement it negotiated in 1985? [15] Finally, in light of the Department of Law's poor track record on TAPS, one must wonder: Is the Department of Law's latest perfunctory notice of its intent to renegotiate the 1985 settlement (*Alaska Budget Report*, Feb. 22, 2007) anything more than the last bureaucratic gasp of acquiescence to the TAPS owners' demonstrated ability to pocket the gains from excessive TAPS tariffs while talking tariff issues to death?

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[14] See Figure 1. These totals do not include the increasing toll the state will be paying in CY 2007 under the recently implemented petroleum profits tax.

[15] On January 27, 2004, the Department of Law announced that it was entering into closed-door talks with the TAPS owners about re-negotiating the 1985 settlement. The Attorney General, who said he had just assembled "a hand-picked, cross-disciplinary team . . . to conduct the negotiations," said that early negotiations "will benefit all the interested parties, particularly explorers, if we can be successful establishing lower and more predictable tariffs for the future. This could be one of the most important steps we take toward promoting increased oil exploration and development." (Alaska Department of Law, "State and TAPS Owners Enter MOU," Jan. 27, 2004 [News Release]).

Eleven months later, the Attorney General announced he was abandoning those negotiations, and that the state would step up its efforts at FERC to recover revenue lost through the settlement the Department of Law had been instrumental in negotiating two decades earlier. At that time, the Attorney General commented: "We resolved the issues last year in part on the understanding that the owners and the state would attempt during the year to negotiate a successor agreement to the existing 1985 TAPS Settlement Methodology, to remove uncertainty in the future," Renkes said. "Unfortunately, we were not successful this year in reaching an agreement. We hope the parties will continue to talk, but in the meantime I have informed the owners that I must protect the state's interests and revenues. We recognize the litigation track may be slow, but it does not preclude simultaneous discussions with the owners." (Alaska Department of Law, "State Protests 2005 Trans-Alaska Pipeline Oil Transportation Tariffs: Attorney General Says Rates Are Too High," Dec. 15, 2004 (News Release).

Three years later, in the failure of the short transition report to incoming Governor Sarah Palin to note the history of the failed 2004 TAPS tariff negotiations is surprising. That report simply stated: "The State needs to issue a notice of renegotiation on January 1, 2007 in order that we keep open the State's option to terminate the [TAPS Settlement] Agreement as of January 1, 2009. Issuance of the notice defers the substantive decision of whether or not the State should opt for an early termination. . . . This action would thus preserve the State's broadest range of options." (Alaska Department of Law Transition Report, December 2006, p. 3 [obtained by the *Alaska Budget Report* under a Freedom of Information Act request]). The report made no mention of what the 2004 negotiation efforts did (or did not) accomplish.

IV. Conclusions

This critical public policy question seldom receives discussion: When TAPS tariff refunds have proven so difficult to secure over the years, what is the fate of the royalty and production tax collections that depend on resolution of the tariff issue? To foster informed discussion of this important public policy question, Figure 1 and the worksheets attached to this report attempt to cut through the administrative and regulatory thickets of oil and gas operations to answer a simple question: What are the economic effects on the state treasury of the differences between the TSM and RCA TAPS tariffs? This question inevitably calls attention to festering administrative problems with important consequences for public policy.

The failure to correct Trans-Alaska Pipeline System (TAPS) tariff overcharges permitted under the 1985 TAPS Settlement Methodology (TSM) will add more than $200 million to the state revenue losses that complex and controversial formula has granted the TAPS owners since oil began flowing from Prudhoe Bay in 1977. Conservatively reckoned, by the end of 2007 those losses will top $3.0 billion (more than $4.5 billion in 2007 dollars).

In addition to the fiscal costs to the state, the pernicious effect of excessive TAPS tariffs shoots a powerful financial dagger directly at a cornerstone of the state's hopes for a North Slope natural gas line. The state hopes that tax incentives, offered at state expense, will encourage independent companies to seek and (hopefully) find the additional natural gas on the North Slope necessary to convert the North Slope natural gas mega-project from a pipe dream into a pipeline. But unless the TAPS tariff overcharges are corrected, a major portion of the incentives offered at state expense would be transferred directly into the hands of the TAPS owners, vitiating the intended benefits of the tax incentives.

Experience demonstrates that the retroactive charges on both tariff refunds to shippers and the resulting royalty and production tax refunds to the state grow increasingly difficult to collect as time passes. In light of the important effects of TAPS tariffs (on both state revenue and independent developers) and the Department of Law's documented historical inability or unwillingness to recognize and respond to the problems engendered by the 1985 settlement in a timely manner, the course of TAPS tariff renegotiations is an issue that warrants close public scrutiny.

Appendices (Calculating Worksheets)

Appendix Worksheet Overview

Worksheet 1	**TAPS Weighted Avg. CY 2007 FERC and RCA Tariffs**
	Comments
Worksheet 2	**TAPS and North Slope Production Shares by Company**
Worksheet 3	**Interstate and Intrastate TAPS Shipment Disposition**
Worksheet 4	**Royalty and Tax Effect Calculating Factors**
Worksheet 5	**State and Federal Income Taxes on TAPS Tariff Gains (Losses): Calculating Factors**
Worksheet 6	**Effects of Using 2007 TSM (FERC) Tariff v. RCA Tariff: Producer-Owner Shipping Own Barrels** (Company, State and Federal Per-Barrel Gains [Losses])
Worksheet 7A	**Effects of Using 2007 TSM (FERC) Tariff v. RCA Tariff: Owner Carrying Others' Barrels** (Company, State and Federal Per-Barrel Gains [Losses])
Worksheet 7B	**Effects of Paying 2007 TSM (FERC) Tariff v. RCA Tariff: Independent Shipper** (Shipper, State and Federal Per-Barrel Gains [Losses])
Worksheet 7C	**Total Effects of Paying 2007 TSM (FERC) Tariff for Independent Production** (Industry, State and Federal Per-Barrel Gains [Losses] v. RCA Tariff)
Worksheet 8	**Effects of Excess TAPS Tariffs on TAPS Owner v. Independent (Non-Owner) Shipper (Comparison)**
	Notes
Worksheet 9	**Estimated Net Effects of Excess TAPS Tariffs for Industry, State and Federal Governments (CY 2007)**
	Comment

Appendix Worksheet Overview

Worksheet 1 presents the five TAPS carrier TSM (FERC) tariffs for 2007 and their weighted average (Lines [1] through [6]), the RCA tariff (Line [7]) and expense v profit estimates for both, (Lines [8] through [11] and the amount by which the weighted average TSM (FERC) tariff exceeds the RCA tariff (Line [12]). The expense and profit estimates, which are based on available public data, are provided for use in subsequent analysis of the effects of tariff overcharges on the various parties involved:

- TAPS owners (who also own more than 95% of production, net of state royalties);
- North Slope producers (more than 95% controlled by TAPS owners; less than 5% by independent producers or shippers);
- State of Alaska (whose taxes and royalty payments are affected by TAPS tariffs);
- Federal government (whose federal income tax receipts are affected by TAPS tariffs).

Worksheets 2, 3, 4 and 5 sketch rough estimating factors for

- TAPS and North Slope ownership percentages (Worksheet 2);
- Interstate v. intrastate shipments (Worksheet 3);
- The relationship between TAPS tariffs and state royalty and petroleum profits tax receipts (Worksheet 4); and
- Rules of thumb for estimating state and federal income taxes as a percentage of profits.

Worksheets 6 and 7 outline, in simplified format, the basic transactions that determine the effects of excess tariffs for the affected parties.

Worksheet 8 re-states the information in Worksheets 6 and 7 to highlight the importance of TAPS tariff overcharges to independent producers, or other shippers who do not have an ownership interest in TAPS.

Worksheet 9 combines information from Worksheets 1 through 7 with anticipated North Slope oil production for CY 2007 to estimate the aggregate revenue consequences of excess TAPS tariffs for the state, the federal government and the industry.

Worksheet 1 — TAPS Weighted Avg. CY 2007 FERC and RCA Tariffs

Line	Item	$ / Bbl.	Notes
	CY 2007 Tariffs Filed by TAPS Owners (PS#1-Valdez)		
1	BP (46.93%)	$5.10	*Ownership: Alyeska Pipeline Service Compoany, "About Us,"*
2	ConocoPhillips (28.29%)	$5.29	http://www.alyeska-pipe.co[illegible]/about.html (accessed 3/30/06);
3	ExxonMobil (20.34%)	$4.95	*Filed tariffs: CY 2007 tariffs filed at FERC (see Anadarko Petrole[illegible]n Corp.*
4	Unocal (1.36%)	$4.75	*and Tesoro Corp., "Protest, Motion to Intervene, Request to Suspend*
5	Koch Alaska (3.08%)	$4.63	*2007 Tariff Filings Subject to Refund . . . .," Dec. 13, 2006, p. 2).*
	Inter-State and Intra-State Filed Tariffs		
6	Wghtd. Avg. FERC Tariff (PS# - Valdez)	**$5.10**	*Weighted Avg. Filed Tariff: = Sum of (each owner's filed tariff) * (ownership percentage)*
7	RCA Tariff (PS# - Valdez)	**$1.96**	*RCA, "Order Rejecting 2006 Intrastate TAPS Settlement Methodology Rates," pp. 3-5.*
	FERC Tariff: After-Tax Profits v. Costs		
8	**Estimated TAPS profits under FERC Tariff**	**$1.02**	*Estimated TAPS Settlement Methodology profit (includes per-barrel allowance + return on new investment + recovery of deferred return [estimated from tariff data reports])*
9	**Estimated TAPS costs under FERC Tariff**	**$4.08**	*Line (6) - Line (8)*
	RCA Tariff:After-Tax Profits v. Costs		
10	**Estimated TAPS Profits under RCA Tariff**	**$0.20**	*Line (7) * 0.10 (assumes 10% return on total TAPS revenue [11.3% on costs)*
11	**Estimated TAPS costs under RCA Tariff**	**$1.76**	*Line (7) - Line (10)*
	Excess Retained by TAPS Owners (FERC tariff v. RCA)		
12	**Excess TAPS Income to TAPS Owners under FERC tariff**	**$3.14**	*Line (6) - Line (7). (Accounting gain or excess realized by TAPS owners on barrels shipped for another company [see Worksheets 6 through 9])*

(See comments on following page.)

(Research Associates, Ester, Alaska 99725, Feb. 1, 2007)

Tariffs (shipping charges) on the 800-mile Trans-Alaska Pipeline System (TAPS) are regulated by two agencies: The Federal Energy Regulatory Commission (FERC) sets tariffs for approximately 90 percent of the oil shipped through TAPS bounnd for markets outside Alaska. Tariffs on the much smaller portion of North Slope oil that remains in state are under the jurisdiction of the Regulatory Commission of Alaska (RCA). Three major oil companies – British Petroleum, ConocoPhillips and ExxonMobil – control approximately 95% of North Slope production and own a similar share of TAPS.

Until 2002, tariffs at FERC and the RCA were determined under a complicated and controversial set of formulae known as the TAPS Settlement Methodology (TSM). Negotiated between the TAPS owners and the Alaska Department of Law in 1985, TSM was supposed to end eight years of expensive and vexatious litigation, reduce tariff uncertainty and prevent future tariff abuse; things didn't work out that way. Litigation over various aspects of the complicated settlement continued. In 1997 Tesoro, an independent shipper, filed a tariff protest at the RCA challenging as excessive the tariffs produced by the TSM formulae. Throughout the proceeding, the state, represented by the Department of Law, defended the settlement its consultants helped establish in 1985 and argued against Tesoro. Culminating five years of litigation, in November 2002 the RCA ordered the TAPS owners to reduce current tariffs on shipments under its jurisdiction by more than 33 per cent. The RCA found that a $1.96 per barrel tariff would allow the TAPS owners to recover all expenses and earn a reasonable profit on their investment. Findings in the RCA's 2002 order repudiated the TSM. For example, the commission noted, during the first 20 years of TAPS operations the settlement methodology TSM enabled the TAPS owners to charge approximately $10 billion more than necessary to pay all costs, plus a reasonable profit.[1] While much of this sum represented internal transfers between the production and shipping arms of the same company, historical TAPS tariff overcharges reduced state revenue by upwards of $4 billion in 2007 dollars (see report text) because transportation charges must be subtracted from the price of oil before royalties and most taxes are calculated. The RCA concluded that the pre-1997 overcharges were beyond its purview and did not try to correct them; its 2002 order reducing tariffs affects only the tariffs the TAPS owners have charged since 1997.

The TAPS owners challenged the RCA order in court. While wrangling over the tariff, during the last four years the TAPS owners have steadily continued to increase TAPS tariffs under the TSM formula still in use at FERC. The current TSM level of $5.10 per barrel is nearly twice the 1997 tariff and more than 2-1/2 times the charges RCA found to be just and reasonable under Alaska statute. Tesoro (and Anadarko (the largest independent producer on the North Slope) have protested both the TSM methodology and current tariff levels at FERC. (In recent years, the state has belatedly protested the tariff increases under TSM at FERC, targeting implementation issues without challenging the 1985 settlement methodology.)

To understand what this marathon case is costing the state, the following worksheets establish a rough basis for estimating the gains and losses for: (1) the TAPS owners, (3) independent shippers, (3) the state of Alaska and (4) the federal governments. This worksheet and the next four establish simple percentage breakdowns and rough rules of thumb that can be applied to current North Slope production and TAPS throughput. Worksheets 6 through 9 apply the relevant factors to calendar-year 2007 North Slope production and pipeline operations.

Excess TAPS tariffs have two major public policy implications: As shown in the CY 2007 summary of estimated effects in Worksheet 8, excess TAPS tariffs penalize the state Treasury by reducing royalty and petroleum profits taxes. Perhaps more importantly, tariff overcharges handicap independent (non-owner) shippers, who must pay that excess to TAPS owners to get their oil to tidewater. That handicap, estimated in Worksheet 8, undercuts the incentives the state is offering to induce new firms to the North Slope.

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[1] 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* (Order P-97-4[151] / P-97-7[110]), Nov. 26, 2002, p. 8.

TAPS and North Slope Ownership Shares and Disposition

Wksht. 2. TAPS and North Slope Production: Shares by Company

Line	Item	TAPS Ownership (%)	Share of N. Slope Production (%)
	TAPS Owners		
1	BP	46.93%	34.20%
2	ConocoPhillips	28.29%	40.63%
3	ExxonMobil	20.34%	20.39%
4	Unocal	1.36%	1.21%
5	Koch Alaska	3.08%	
	Other Companies		
6	Anadarko		2.90%
7	Chevron		0.64%
8	All Others		0.03%
9	*Totals*	100.00%	100.00%
	Subtotals		
10	TAPS Owners (5 Companies)	100.00%	96.43%
11	BP, ConocoPhillips and ExxonMobil	95.56%	95.22%
12	Non-TAPS Owners	(N.A.)	3.57%

Sources:

TAPS Ownership: Alyeska Pipeline Service Company, "About Us," http://www.alyeska-pipe.com/about.html (accessed 3/30/06).

North Slope Production Shares (CY 2005): From Alaska Department of Natural Resources, Division of Oil and Gas, "Summary of Total North Slope Volumes By Lessee Subject to Royalties as of December-05 (Calendar Year-to-date)"

Worksheet 3. Interstate and Intrastate TAPS Shipment Disposition

Line	Item	N. Slope Production (bpd or %)
	Throughput Totals and Percentages	
1	Total Throughput, FY 2008-2012	790,000
2	Intrastate Shipments	87,000
3	Interstate Shipments	703,000
4	Intrastate Shipments as % of Total	11.0%
5	Interstate Shipments as % of Total	89.0%

Sources:

1 *Alaska Dept. of Revenue. Fall 2006 Revenue Sources Book, p. 12 (FY 2008-2012 average)*
2 *Regulatory Commission of Alaska, Docket P-97-4, Order No. 151, p. 2.*
3 *Line (1) - Line (2)*
4 *Line (2) / Line (1)*
5 *Line (2) / Line (1)*

(Research Associates, Ester, Alaska 99725, Feb. 1, 2007)

Royalty and Tax Effect Calculating Factors

Worksheet 4. Estimating State Royalty and Petroleum Profits Tax Effects of TAPS Tariff Gains (Losses) *

Transportation charges are subtracted from the price of oil to determine both royalty and petroleum profits tax payments to the state. For this reason, the state loses approximately $0.26 on every tariff dollar charged. The loss to the state attributable to excess TAPS tariffs is roughly estimated as follows:

Royalty – (12.5% of value, net of transportation costs) –	$1.00 * 0.125 =	$0.125
Production Tax – (estimated effective rate of 15% of post-royalty value at $55.00/bbl.) –	$1.00 * 0.875 * 0.15 =	<u>$0.131</u>
		$0.256

Compared to the loss of state revenue due to excess TAPS tariffs under the old, ELF-based production tax regime, on a per-barrel basis the loss represents an increased loss to the state of approximately $0.05 per barrel. Note: State income taxes offset these losses, but only to a limited extent (see Worksheet 5).

** Estimated from Alaska Department of Revenue Data (see: <u>Fall 2006 Revenue Sources Book</u>, pp. 15-17)*

Worksheet 5. State and Federal Income Taxes on TAPS Tariff Gains (Losses): Calculating Factors

Pipeline tariffs, paid by shippers, include income tax payments on pipeline profits. Therefore, to calculate the net gains to the TAPS owners, shippers, the state and the federal government due to tariff changes, it is necessary to estimate income tax payment effects. This worksheet shows the income tax calculating factors used in these worksheets.

Line	*Item*	*$ / bbl. Gain (Loss)*	*How Calculated (see comments below)*
1	Profit Before Income Taxes	$1,000.00	Profit received from shippers.
2	State Income Tax (SIT)	$37.50	Assumed 3.75% SIT effective rate for SIT (see notes below)
3	Federal Income Tax	$192.50	Assumed 20.0% effective rate on post-SIT profit
4	After-Tax Net Profit	$770.00	(Line [1]) - (Lines [2] + [3])

For these exercises, the effective State Income Tax (SIT) rate is assumed to be 3.75% of before-tax profits (a factor frequently used by state consultants to estimate SIT). The Federal Income Tax (FIT) rate is assumed to be 20% of the remaining profit. (For discussion of estimated income tax payments on North Slope production and pipeline operations, see: <u>The Profitability and Economic Viability of Alaska North Slope and Associated Pipeline Operations</u> [prepared for the Prince William Sound Regional Citizens' Advisory Council, April 27, 2005], Ch. 4.G.).

(Research Associates, Ester, Alaska 99725, February 2007)

Worksheet 6. Effects of Using 2007 TSM (FERC) Tariff v. RCA Tariff: Producer-Owner Shipping Own Barrels

(Company, State and Federal Per-Barrel Gains [Losses]) *

Line	Item	$ / bbl. Gain (Loss)	How Calculated (see comments below)
	TAPS Owner Gain (Loss) on Own Barrels		
1	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	$5.10	Worksheet 1, Line (6) (received from TAPS owner's production arm)
2	RCA Tariff (PS#1 - Valdez)	$1.96	Worksheet 1, Line (7)
3	Est. TAPS per-barrel operating and capital costs	($1.76)	Worksheet 1, Line (11)
4	Excess TAPS Income to TAPS Owners	$0.00	Internal Transfer
5	Estimated Profit on RCA tariff Paid to TAPS Owners	$0.20	Line 2 * 0.1 (Worksheet 1, Line 10)
6	Co. Gain from Reduced Royalty & Production Tax	$0.80	(Line [1] - Line [2]) * .256 (see Worksheet 5)
7	Est. added SIT Paid by TAPS Owners at End of Year	($0.03)	Line (6) * -1 * 0.0375 (see Worksheet 5)
8	Est. added FIT Paid by TAPS Owners	($0.15)	(Line [6] + Line [7]) * -1 * 0.20 (see Worksheet 5)
9	**TAPS Owner Net Revenue Gain (Loss)**	**$0.62**	Sum of Lines (6) through (8)
	State Gain (Loss) When Producer Ships Own Barrels Using FERC Tariff		
10	State Royalty & Production Tax Gain (Loss)	($0.80)	Line (6) * -1
11	State SIT Gain (Loss)	$0.03	Line (7) * -1
12	**Total State Gain (Loss)**	**($0.77)**	Line (10) + Line (11)
	Federal Gain (Loss) When Producer Ships Own Barrels Using FERC Tariff		
13	**Federal Gain (Loss)**	**$0.15**	Line (8) * -1

* This worksheet estimates TAPS owner, state and federal net revenue gain (loss) per barrel from shipping its own barrels under the tariff allowed by the Federal Energy Regulatory Commission (FERC), compared to the RCA tariff. Because FERC tariff governs nearly 90% of all TAPS shipments, these estimates apply to the preponderance of the oil shipped on TAPS. Moreover, because three companies own more than 95% of TAPS and control a similar share of North Slope production, the preponderance of the net revenue gains in Line (9) accrue to these firms.

The per-barrel totals at Lines (9), (12) and (13) include owner gains (losses) from reduced royalties and taxes due to higher tariffs (shown on Line [6]), as well as the estimated state and federal income tax effects resulting from the royalty and production tax changes. But for the vertically integrated company, the $3.14 tariff increase (Worksheet 1, Line [12]) that reduces state royalty and production tax payments is not new revenue; rather, it is a transfer from the production to the transportation unit of the same company. Therefore, the increased tariff itself is recorded on Line (4) as a net-zero transfer. On the assumption that the TAPS owner would realize the basic profit shown in Line (5) under any circumstances, the company gains shown on that line are not included in Line (9) and therefore do not affect state or federal income taxes at Lines (7) and (8), which result from the company gain on Line (6).

Worksheet 7A. Effects of Using 2007 TSM (FERC) TAPS Tariff v. RCA Tariff: Owner Carrying Others' Barrels

(Company, State and Federal Per-Barrel Gains [Losses]) *

Line	Item	$ / bbl. Gain (Loss)	How Calculated (see comments below)
	TAPS Owner Gain (Loss) Carrying Others' Barrels		
1	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	$5.10	Worksheet 1, Line (6) (received from TAPS owner's production arm)
2	RCA Tariff (PS#1 - Valdez)	$1.96	Worksheet 1, Line (7)
3	Est. TAPS per-barrel operating and capital costs	($1.76)	Worksheet 1, Line 11
4	Excess TAPS Income to TAPS Owners	$3.14	Line (1) - Line (2)
5	Estimated Profit on RCA tariff Paid to TAPS Owners	$0.20	Line 2 * 0.1 (Worksheet 1, Line 10)
6	Owner Gain from Reduced Royalty & Production Tax	$0.00	Accrues to the Independent Producer (recorded on Worksheet 7B)
7	Est. added SIT Paid by TAPS Owner at End of Year	($0.12)	Line (4) * -1 * 0.0375 (see Worksheet 5)
8	Est. added FIT Paid by TAPS Owners	($0.60)	(Line [4] - Line [7]) * 0.20 (see Worksheet 5)
9	**TAPS Owner Net Revenue Gain (Loss)**	**$2.42**	Line (4) + Sum of (Lines [6] through [8])
	State Gain (Loss) When TAPS Owner Carries Others' Barrels Using FERC Tariff		
10	State Royalty & Production Tax Gain (Loss)	$0.00	Recorded on Worksheet 7B (see Line [6])
11	State SIT Gain (Loss)	$0.12	Line (7) * -1
12	**Subtotal State Gain (Loss)**	**$0.12**	Line (10) + Line (11)
	Federal Gain (Loss) When TAPS Owner Carries Others' Barrels Using FERC Tariff		
13	**Subtotal Federal Gain (Loss)**	**$0.60**	Line (8) * -1

** This worksheet estimates TAPS owner, state and federal net revenue gain (loss) per barrel when the TAPS owner carries the barrels of others, charging them the higher Federal Energy Regulatory Commission (FERC) tariff, compared to the RCA tariff. Effects on the independent shipper and the resulting changes to state and federal income tax payments are estimated in Worksheet 7B; the net effects of this transaction are summarized in Worksheet 7C, which combines the effects of Worksheets 7A and 7B. Since the major TAPS owners control an estimated 95% of both North Slope production and TAPS, these estimated results apply to less than 5% of the barrels shipped on TAPS under the higher, FERC-approved tariff.*

The principal differences between this worksheet and Worksheet 6 involve the cash flows at Lines (4) and (6). In this transaction, the TAPS owner receives in estimated $3.14 per barrel in excess to the RCA tariff; as shown in Line (4); in Worksheet 6, this amount is an internal transfer that does not generate new revenue. At Line (6) of this worksheet, the TAPS owner realizes no direct benefit from reduced royalties and petroleum profits tax payments (these gains accrue to the independent producer and are shown in shipper's Worksheet 7B). The resulting effects on state and federal income taxes are shown in Lines (7) and (8); the bottom line results for the TAPS owner, state and the federal government are shown at Lines (9), (12) and (13).

(Research Associates, February 2007)

Worksheet 7B. **Effects of Paying 2007 TSM (FERC) TAPS Tariff v. RCA Tariff: Independent Shipper**
(Shipper, State and Federal Per-Barrel Gains [Losses]) *

Line	Item	$ / bbl. Gain (Loss)	How Calculated (see comments below)
	Independent Shipper Gain (Loss)		
1	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	$5.10	Worksheet 1, Line (6) (paid to TAPS owner)
2	RCA Tariff (PS#1 - Valdez)	$1.96	Worksheet 1, Line (7)
3	Est. TAPS per-barrel operating and capital costs	($1.76)	Worksheet 1, Line (11)
4	Excess TAPS Income to TAPS Owners	($3.14)	(Line [1] - Line [2]) * -1
5	Estimated Profit on RCA tariff Paid to TAPS Owners	$0.20	Line 2 * 0.1 (Worksheet 1, Line 10)
6	Co. Gain from Reduced Royalty & Production Tax	$0.80	(Line [4]) * -1 * .256 (see Worksheet 4)
7	Effect on SIT Paid by Independent Shipper	$0.09	(Line [4] + Line [6]) * -1 * 0.0375 (see Worksheet 5)
8	Effect on FIT Paid by Independent Shipper	$0.45	(Line [4] + Line [6] + Line 7) * -1 * 0.20 (see Worksheet 5)
9	**Independent Shipper Net Revenue Gain (Loss)**	**($1.80)**	Line (4) + Sum of (Lines [6] through [8])
	State Gain (Loss) When Indpendent Shipper Pays FERC Tariff		
10	State Royalty & Production Tax Gain (Loss)	($0.80)	Line (6) * -1
11	State SIT Gain (Loss)	($0.09)	Line (7) * -1
12	**Subtotal State Gain (Loss)**	**($0.89)**	Line (10) + Line (11)
	Federal Gain (Loss) When Independent Shipper Pays FERC Tariff		
13	**Subtotal Federal Gain (Loss)**	**($0.45)**	Line (8) * -1

** This worksheet estimates independent shipper, state and federal net revenue gain (loss) per barrel when the TAPS owner carries the barrels of others, charging them the higher Federal Energy Regulatory Commission (FERC) tariff, compared to the RCA tariff. Effects on the TAPS owner and the resulting changes to state and federal income tax payments are estimated in Worksheet 7B. The net effects of this transaction are summarized in Worksheet 7C, which combines the effects of Worksheets 7A and 7B. Since the major TAPS owners control an estimated 95% of both North Slope production and TAPS, these estimated results apply to less than 5% of the barrels shipped on TAPS under the higher, FERC-approved tariff. As in Worksheet 7A, state and federal infcome tax effects are shown at Lines (7) and (8), while the bottom line for the independent producer, state and federal governments are shown at Lines (9), (12) and (13).*

The principal differences between this worksheet and Worksheets 7A derive from the different cash flows at Lines (4) and (6). On this side of the transaction, the independent shipper pays an estimated $3.14 per barrel in excess to the RCA tariff at Line (4). This out-of-pocket payment to the TAPS owners is only partially offset by gains from reduced royalties and petroleum profits tax payments, shown on Line (6). As a result, after tax effects are reckoned, the independent shipper is down $1.80, as shown at Line (9). On the other side of this transaction, the TAPS owner gains $2.42, as shown at Line [9] of Worksheet 7A.

(Research Associates, February 2007)

Worksheet 7C. **Total Effects of Using 2007 TSM (FERC) Tariff for Independent Production**
(Industry, State and Federal Net Per-Barrel Gains [Losses] v. RCA Tariff)*

Line	Item	$ / bbl. Gain (Loss)	How Calculated (see comments below)
	Total TAPS Owner and Independent Shipper Net Gain (Loss)		
1	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	$5.10	Worksheet 1, Line (6)
2	RCA Tariff (PS#1 - Valdez)	$1.96	Worksheet 1, Line (7)
3	Est. TAPS per-barrel operating and capital costs	($1.76)	Worksheet 1, Line (11)
4	Excess TAPS Income to TAPS Owners	$0.00	Sum of Worksheets 7A and 7B, Line (4)
5	Estimated Profit on RCA tariff Paid to TAPS Owners	$0.20	Line 2 * 0.1 (Worksheet 1, Line 10)
6	Total Co. Gain from Reduced Royalty & Production Tax	$0.80	Sum of Worksheets 7A and 7B, Line (6)
7	Total Effect on SIT for Independent Shipper Transaction	($0.03)	Sum of Worksheets 7A and 7B, Line (7)
8	Total Effect on FIT for Independent Shipper Transaction	($0.15)	Sum of Worksheets 7A and 7B, Line (8)
9	**Total Owner and Independent Shipper Revenue Gain (Loss)**	**$0.62**	Sum of Lines (4) + (Lines [6] through [8])
	Total State Gain (Loss) When Indpendent Shipper Uses FERC Tariff		
10	State Royalty & Production Tax Gain (Loss)	($0.80)	Line (6) * -1
11	State SIT Gain (Loss)	$0.03	Line (7) * -1
12	**Total State Gain (Loss)**	**($0.77)**	Line (10) + Line (11)
	Total Federal Gain (Loss) When Independent Shipper Uses FERC Tariff		
13	**Total Federal Gain (Loss)**	**$0.15**	Line (8) * -1

** This worksheet combines the net revenue totals from Worksheets 7A and 7B to estimates total TAPS owner and independent shipper, state and federal net revenue gain (loss) per barrel when shipping independent barrels using the tariff allowed by the Federal Energy Regulatory Commission (FERC), compared to the RCA tariff. As noted on the previous worksheets, Independent shipments constitute less than five per cent (5%) of all barrels shipped on TAPS under the higher, FERC-approved tariff.*

Although the TAPS owner gains from shipping an independent producer or shipper's barrels while the independent producer or shipper loses money, when the results from both sides of this transaction are combined, the net effects for the industry, the state and the federal government turn out to be identical to the revenue effects for the TAPS owner shipping its own barrels, as reported in Worksheet 6. (For discussion of the policy implications of the differences between Worksheets 7A and 7B, see comments attached to Worksheet 9.)

Worksheet 8. Effects of Excess TAPS Tariffs on TAPS Owner v. Independent (Non-Owner) Shipper (Comparison) *

Line	TAPS Owner, State Per-Bbl. Gain (Loss)	$ / bbl. Gain (Loss)	Independent Shipper, State Per-Bbl. Gain (Loss)	$ / bbl. Gain (Loss)
1	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	$5.10	Wghtd. Avg. TSM (FERC) Tariff (PS#1 - Valdez)	($5.10)
2	RCA Tariff (PS#1 - Valdez)	$1.96	RCA Tariff (PS#1 - Valdez)	$1.96
3	Est. TAPS per-barrel operating and capital costs	($1.76)	Est. TAPS per-barrel operating and capital costs	($1.76)
4	Excess TAPS Income to TAPS Owners	$3.14	Excess TAPS Income to TAPS Owners	($3.14)
5	Est. After-Tax Profit on RCA tariff Paid to TAPS Owners	$0.20	Est. After-Tax Profit on RCA tariff Paid to TAPS Owners	$0.20
6	Co. Gain from Royalty & Production Tax Reduction	$0.00	Co. Gain from Royalty & Production Tax Reduction	$0.80
7	Est. added SIT Paid by TAPS Owners at End of Year	($0.12)	Est. Gain from Reduced SIT Paid by TAPS Shippers	$0.09
8	Est. added FIT Paid by TAPS Owners	($0.60)	Est. Gain from Reduced FIT Paid by TAPS Shippers	$0.45
9	TAPS Owner Net Revenue Gain (Loss)	$2.42	Independent Shipper Gain (Loss)	($1.80)
10	= = = >		**Difference in TAPS Owner Gain and Non-Owner Loss on TAPS Shipments by Independent Producer / Shipper**	**$4.22**
11	State Revenue Gain (Loss)	$0.12	State Revenue Gain (Loss)	($0.89)
12	= = = >		**State Net Revenue Gain (Loss) from TAPS Shipments by Independent Producer / Shipper**	**($0.77)**

How Calculated (see notes on following page)

Line	TAPS Owner	Independent Shipper
1	Worksheet 1, Line [6] (received from TAPS Owner's production unit)	Worksheet 1, Line [6]) * -1 (paid to TAPS Owner)
2	Worksheet 1, Line [7]	Worksheet 1, Line [7]
3	(Worksheet 1, Line [11]) * -1	(Worksheet 1, Line [11]) * -1
4	Line (1) - Line (2) (see Wksht. 1, Line [12])	Line (1) - Line (2) (see Wksht. 1, Line [12])
5	Line (2) * 0.1 (Worksheet 1, Line [10])	Line (2) * 0.1 (Worksheet 1, Line [10])
6	(Royalty and petroleum profits tax gain accrues to Producer or Shipper)	Owner's Line 4 * 0.256 (per Worksheet 4)
7	(Line [4]) * 0.0375 (per Worksheet 5)	(Line [6]) * 0.0375 (per Worksheet 5)
8	Sum of (Line [4] + [6] + [7]) * 0.20 (per Worksheet 5)	Sum of (Lines [4] + [6] + [7]) * 0.20 (per Worksheet 5)
9	(Line [4] + Sum of (Line [6] through Line [8]) (See \worksheet 7A)	(Line [4] + Sum (Line [6] through Line [8]) (See \worksheet 7B)
10	= = = >	Owner's Line (9) - Shipper's Line (9)
11	(Line [7]) * -1	(Line [7]) * -1
12	= = = >	Owner's Line (11) + Shipper's Line (11)

*** This transaction analysis does not attempt to quantify owner gains (losses) from shipping its own barrels (see notes on following page.)***

Research Associates, February 2007

Worksheet 8
(Notes)

Effects of Excess TAPS Tariffs on TAPS Owner v. Independent (Non-Owner) Shipper Owner (Comparison) *

The purpose of this worksheet is to contrast the consequences for an independent party of shipping a barrel of North Slope crude oil on TAPS under the TSM (FERC) tariff, compared to the RCA tariff. To this end, this worksheet puts key data from Worksheets 7A and 7B on a single page, rather than combining the results (as in Worksheet 7C). The TAPS owner gains on this transaction delineated in **Worksheet 7A** are shown in the left-hand column of this worksheet. On the flip side of the same transaction, the independent shipper losses shown in **Worksheet 7B** are displayed in the right-hand column.

To summarize this transaction analysis: When TAPS carries a barrel of oil for an independent producer or shipper in interstate commerce, the TAPS owner gains $2.42 from the difference between the FERC-approved TAPS tariff (5.10 per barrel) and the RCA's tariff for oil that stays in Alaska ($1.96 per barrel).On the other hand, the independent shipper incurs a $1.80 per barrel loss. In sum, from a cash flow standpoint, the excess in the TSM (FERC) tariff penalizes the independent shipper on TAPS $4.22 per barrel, compared to the TAPS owner. This handicap to independent developers results from the $3.14 excess in the FERC tariff, compared to the RCA tariff.

—

** This transaction analysis does not consider TAPS owner costs, gains and/or losses from shipping its own barrels. As shown in Worksheets 6 and 7B, the TAPS owner shipping its own barrels under the TSM realizes a net gain of $0.62 per barrel due to the higher FERC tariff (Worksheet 6, Line [9]), while the independent producer or shipper incurs a $1.80 per barrel loss (Worksheet 7B, Line [9]).*

Worksheet 9. Estimated Net Effects of Excess TAPS Tariffs for Industry, State and Federal Governments (CY 2007)

(A)	(B)	(C)	(D)	(E)
	Assumptions			***Notes***
1	North Slope Production, CY 2007	276.31 million bls.		*From Alaska Dept. of Revenue, Revenue Sources Book, Fall 2006, p. 12 (est. 757,000 bpd).*
2	N. Slope Production by TAPS Owners (96.43%)	266.44 million bls. *		*(2C) = (1C) * 0.9643 (See Worksheet 2)*
3	Independent Production (3.57%)	9.86 million bls. *		*(3C) = (1C) * 0.0357 (see Worksheet 2)*
4	Interstate Barrels (Percentage)	89.00% *		*See Worksheet 3*
		Per-barrel Gain (Loss) * *($ / bbl.)*	***Net Effect – Gain (Loss)*** ** *(Million $)*	***Calculating Factors*** ***
	State Revenue Gain (Loss): TSM v. RCA Tariffs			
5	TAPS Owner Carrying Own Barrels	($0.77)	($205.16)	*(5D) = (2C) * (5C)*
6	TAPS Owner Carrying Others' Barrels	($0.77)	($7.60)	*(6D) = (3C) * (6C)*
7	Total State Revenue Gain (Loss)		**($212.75)**	*(7D) = (5D) + (6D)*
	Federal Revenue Gain (Loss): TSM v. RCA Tariffs			
8	TAPS Owner Carrying Own Barrels	$0.15	$39.97	*(8D) = (2C) * (8C)*
9	TAPS Owner Carrying Others' Barrels	$0.15	$1.48	*(9D) = (3C) * (9C)*
10	Total Federal Revenue Gain (Loss)		$41.45	*(10D) = (8D) + (9D)*
	Industry Net Gain (Loss): : TSM v. RCA Tariffs			
11	TAPS Owner Carrying Own Barrels	$0.62	$165.19	*(11D) = (2C) * (11C)*
12	TAPS Owner Carrying Others' Barrels	$0.62	$6.12	*(12D) = (3C) * (12C)*
13	Total Industry Revenue Gain (Loss)		$171.31	*(13D) = (11D) * (12D)*

* *Factors in Col. (C) are calculated on Worksheets 6 and 7C at Lines (9), (12) and (13).*

** *Assumes TAPS owners use FERC tariff to calculate royalty and production tax on in-state barrels while challenging RCA TAPS tariff orders.*

*** *In-state and independent producer volumes and calculating factors are displayed here to show their approximate volumes.*

Worksheet 9
(Comment)

Estimated Net Effects of Excess TAPS Tariffs for Industry, State and Federal Governments (CY 2007)

During calendar year 2007, reduced state royalty and production tax payments due to excess TAPS tariffs will reduce state revenue by approximately $213 million, compared to the revenue the state would have received from application of the Regulatory Commission of Alaska (RCA) TAPS tariff to all barrels shipped on TAPS. Because the TAPS owners continue to collect their filed tariffs in interstate commerce while they challenge the RCA's order requiring reduced tariffs and tariff refunds on intrastate shipments, this estimate reflects state losses in both interstate and in-state shipments, using the estimate of what the state gives up per barrel of oil shipped commerce (Line [12] of Worksheets 6 and 7C).

In terms of aggregate industry, state and federal results of excess tariffs, whether the TAPS owner is carrying its own barrel or the barrel of an independent producer or shipper does not affect the outcome of these calculations. That is because the handicap to the independent producer or shipper due to excess TAPS tariffs under TSM (quantified for the current year in Worksheet 7A) and the benefits of that shipping arrangement to the TAPS owner (shown in Worksheet 7B) combine to cancel each other out (Worksheet 7C). For this reason, the total effects on state, federal and industry revenue (as shown in Column C of Worksheet 9) are the same when a barrel of oil produced on the North Slope is shipped on TAPS by a TAPS owner, and when it is shipped by an independent producer or shipper.

These worksheets illustrate how the focus on total state revenue can mask the importance of other public policy consequences, such as the effects of excess TAPS tariffs on independent producers or shippers. Consider: In 2006, the State Legislature replaced the severance tax with a petroleum profits tax (PPT), which was designed to increase the state's petroleum revenue "take" while offering investment incentives to prospective developers in the form of tax deductions and write-offs. A major purpose of these inducements – offered at state expense – was to draw new developers to the North Slope in hopes that they would discover the additional natural gas necessary to assure the economic viability of the long-delayed natural gas pipeline from Prudhoe Bay to southern markets. But Worksheets 7A and 7B reveal a major reason why prospective independent developers may hesitate to come to Alaska. Worksheet 7A shows that when TAPS carries a barrel of oil for an independent producer or shipper, the TAPS owner gains $2.42 from the excess charges embedded in the $5.10 TAPS tariff. On the flip side of the same transaction, the independent shipper loses $1.80 per barrel. In other words, the first $1.80 given up by the state in tax incentives would simply neutralize the penalty that excess TAPS tariffs currently impose on the independent shipper for the benefit of the TAPS owner. But these incentives do not level the playing field because the TAPS owners are eligible for the same tax benefits. As shown in Worksheet 8, as a result of the excess tariffs permitted by TSM, the independent shipper currently faces a $4.22 per barrel handicap, relative to the TAPS owner. That handicap is the net effect of the $3.14 excess in the FERC tariff, according to the RCA reckoning, identified in Worksheet 1.

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DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT

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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

The Regulatory Commission of Alaska (RCA) issued an order today finding that the Trans-Alaska Pipeline System (TAPS) intrastate rates for the years 1997 through 2000 were excessive. The order sets rates in accordance with the Alaska Pipeline Act and directs the TAPS Carriers to calculate and pay refunds to. Shippers who transported oil during those years. Based on an analysis of the TAPS Carriers' annual revenue requirements, the rate 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. The rates set for 1997 to 2000 are based on costs reported to the Federal Energy Regulatory Commission annually and depreciation recovered through filed rates through the end of 1996. The RCA found that the maximum TAPS intrastate filed rates for the years 1997 through 2000 exceed cost-based rates by an average of 57 percent.

This order is the first time in the more than twenty years of Trans Alaska Pipeline operations that a regulatory agency has reviewed TAPS rates for consistency with statutory standards. Rates before 1996 were determined according to a settlement methodology and based on confidential reports.

A copy of the full text of the order is available on the RCA's website at http://www.state.ak.us/rca/orders/2002/P97004_151.pdf

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

BP PIPELINES (ALASKA) INC.	DOCKET NO. IS05-82-002
CONOCOPHILLIPS TRANSPORTATION ALASKA INC.	DOCKET NO. IS05-80-002
EXXONMOBIL PIPELINE COMPANY	DOCKET NO. IS05-72-002
KOCH ALASKA PIPELINE COMPANY	DOCKET NO. IS05-96-002
UNOCAL PIPELINE COMPANY	DOCKET NO. IS05-107-001
STATE OF ALASKA	DOCKET NO. OR05-2-001
v.	
BP PIPELINES (ALASKA) INC.	
EXXONMOBIL PIPELINE COMPANY	
CONOCOPHILLIPS TRANSPORTATION ALASKA INC.	
UNOCAL PIPELINE COMPANY	
KOCH ALASKA PIPELINE COMPANY	
ANADARKO PETROLEUM CORPORATION	DOCKET NO. OR05-3-001
v.	
TAPS CARRIERS	
BP PIPELINES (ALASKA) INC.	DOCKET NO. OR05-10-000
BP PIPELINES (ALASKA) INC.	DOCKET NO. IS06-70-000
EXXONMOBIL PIPELINE COMPANY	DOCKET NO. IS06-71-000
CONOCOPHILLIPS TRANSPORTATION ALASKA INC.	DOCKET NO. IS06-63-000
UNOCAL PIPELINE COMPANY	DOCKET NO. IS06-82-000
KOCH ALASKA PIPELINE COMPANY, L.L.C.	DOCKET NO. IS06-66-000
STATE OF ALASKA	DOCKET NO. OR06-1-000
v.	
BP PIPELINES (ALASKA) INC.	
EXXONMOBIL PIPELINE COMPANY	
CONOCOPHILLIPS TRANSPORTATION ALASKA INC.	
UNOCAL PIPELINE COMPANY	
KOCH ALASKA PIPELINE COMPANY	
ANADARKO PETROLEUM CORPORATION	DOCKET NO. OR06-2-000
v.	
TAPS CARRIERS	

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February 16, 2007

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(c) The Carriers failed to offer a TAPS cost of service and proposed an Opinion 154-B analysis using incorrect depreciation reserves and an inflated rate base. 29

(d) Mere comparison of RCA intrastate rates to TSM-based interstate rates and defectively computed Opinion 154-B rates is insufficient to establish the first critical element of a Section 13(4) case. 37

2. The Carriers failed to show that conditions as to the movement of intrastate traffic were not more favorable than those existing in interstate commerce. 43

3. The Carriers failed to prove that intrastate rates cast an undue burden on interstate commerce or on interstate shippers. 43

(a) The Carriers failed to show that intrastate shippers materially compete in and could materially affect interstate commerce. 44

(b) The Carriers fail to show that the RCA's intrastate rates have caused increased use by Alaska refineries of ANS crude. 46

(c) The Carriers fail to show that the RCA's intrastate rates caused major West Coast refinery investments. 48

(d) The Carriers and their parent companies dominate the interstate ANS crude market; independent Alaska refineries have a negligible effect on that market. 49

(e) The Carriers failed to demonstrate any injury to interstate shippers has resulted and will continue to result because of the disparity in rates. 50

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Interstate Commerce Act, 49 U.S.C. § 13(4) (1976), reprinted in 49 U.S.C. app. § 13(4) (1988) .... passim

Transportation Act of 1920, 41 Stat. 456 (1920) .... passim

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To: The Honorable Carmen A. Cintron
Presiding Administrative Law Judge

INITIAL BRIEF OF THE REGULATORY COMMISSION OF ALASKA

The Regulatory Commission of Alaska ("RCA") submits this Initial Brief to the Presiding Administrative Law Judge ("Presiding Judge") demonstrating that the Section 13(4) Petition ("Petition") filed by the TAPS Carriers under the Interstate Commerce Act[1] to raise intrastate oil pipeline rates in Alaska should be denied.[2] As discussed below, Section 13(4) of the ICA does not authorize FERC to prescribe intrastate rates for oil pipelines because the scope of Section 13(4) authorization is restricted to prescribing intrastate rates for railroads. Even if Section 13(4) does apply to intrastate oil pipeline rates, the Carriers have entirely failed to make their *prima facie* case.[3]

Before setting forth its arguments, the RCA provides a Summary of Argument for ease of reading and as an overview of the brief.

SUMMARY OF ARGUMENT

Under Section 13(4) of the ICA, FERC has no jurisdiction to prescribe the intrastate rates of oil pipelines. The states enjoy exclusive jurisdiction to set intrastate rates. In enacting the ICA, Congress expressly limited the jurisdictional reach of

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1 Interstate Commerce Act, 49 U.S.C. § 13(4) (1976), reprinted in 49 U.S.C. app. § 13(4) (1988).

2 The RCA stresses that its litigation posture is entirely distinct from that of the State of Alaska in this proceeding. The State of Alaska is represented by separate counsel and is a distinct entity from the RCA for purposes of this proceeding.

3 The Argument section of this Initial Brief follows the Joint Stipulation of Issues (corrected October 25, 2006). Relevant statutes are set forth in Appendix A. The relevant procedural history of the intrastate rate proceedings is set forth in Appendix B. Key terms, *e.g.*, ICA, are included as a Glossary in Appendix C.

Section 13(4) to the intrastate rates of railroads. For this reason, no cases have been found in which the ICC or FERC exercised authority under Section 13(4) to prescribe intrastate oil pipeline rates.[4]

Even if the Presiding Judge determines that FERC has Section 13(4) jurisdiction, the Carriers have failed to prove a *prima facie* case. They have failed to provide any evidentiary basis for FERC to exercise Section 13(4) authority to nullify and supersede the intrastate rates that were determined to be just and reasonable in the RCA proceedings. The United States Supreme Court has established strict requirements and conditions regarding the nature of the hearing, findings and evidence required to support a Section 13(4) petition. None of those conditions has been satisfied by the evidence proffered by the Carriers. In Section I of its Argument, the RCA shows that the Carriers have the burden of proving their Section 13(4) Petition, and in Section V.C the RCA discusses the high standard of proof that applies to a Section 13(4) proceeding.

In Section V.B, the RCA summarizes the procedural history and legal conclusions of its Order 151 in which it established the intrastate rates at issue here. After six years of administrative proceedings, the RCA rejected the TSM rates and instead established cost-based rates for the period 1997-2000 on the basis of a depreciated original cost ("DOC") methodology. For the past seven years, the Carriers have refused to file cost-based tariffs compliant with Order 151 requirements to try to raise intrastate rates.

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[4] *See* Section V.A.

As discussed in detail in Section V.C, the United States Supreme Court has identified five elements of a *prima facie* case under Section 13(4): (1) abnormally low and non-compensatory intrastate rates; (2) that conditions of intrastate transportation are not more favorable than those in interstate commerce; (3) that intrastate rates cast an undue burden on interstate commerce; (4) that the requested increase of intrastate rates would produce a needed and cost-justified revenue increase; and (5) that the requested increase would not cause intrastate rates to be unreasonable. Because the Carriers prove none of these five elements, the Presiding Judge must reject their Petition.

The Carriers' Petition must be dismissed for their failure to submit actual cost-of-service evidence at FERC demonstrating that the intrastate rates cannot recover the cost of providing intrastate service. As a substitute for cost-of-service evidence, the Carriers rely on TSM rates and claim that the intrastate rates are unreasonably low because they are less than TSM rates. If the Presiding Judge rejects TSM rates, as the RCA believes she must based on Supreme Court precedent, the Section 13(4) case disappears because the Carriers' Section 13(4) case is premised on the difference between TSM rates and Order 151 rates. In fact, without the foundation of actual cost-of-service evidence, the Carriers' Section 13(4) claims are reduced to tautology: the TSM rates are reasonable because they are based on the TSM and the RCA cost-based rates are unreasonable because they are not TSM rates.[5]

In contrast to the Carriers' failure to present actual cost evidence to show that the Order 151 rates are not compensatory, the RCA in Order 151 conducted a thorough

[5] *See* Section V.D.1.

and detailed analysis of the Carriers' intrastate costs and established rates that provide the Carriers with recovery of their costs of operations, return of capital, and a reasonable return on their investment.[6] The Carriers fail to show that those Order 151 rates do not compensate them for their reasonable costs. The Carriers also fail to offer any evidence or even any explanation showing that cost-based rates such as the Order 151 rates could under any circumstances be discriminatory vis-à-vis other rates.

The fatal shortcomings of the Carriers' case also include a failure to present substantial evidence that the Order 151 rates harm interstate commerce or any individual shippers.[7] Their case is based on conjecture and speculation. They are unable to show substantial injury or even a quantifiable injury of any level to interstate commerce or shippers. In short, the Carriers match their failure to submit any cost evidence to corroborate their Section 13(4) claims with a corresponding failure to proffer evidence of any actual harm to interstate commerce arising out of the relationship between the intrastate and interstate rates. Consistent with their other failures, the Carriers also fail to show that raising intrastate rates will have any positive effect on interstate commerce or that raising Order 151 rates would produce just and reasonable rates.[8]

Additional negative impacts weigh against any change to the Order 151 rates. These additional factors are discussed in Section V.D.6 of the Argument. First, raising intrastate rates would have negative public policy repercussions that outweigh any

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[6] *See* Section V.B.

[7] *See* Section V.D.3.

[8] *See* Sections V.D.4 and 5.

positive effect on interstate commerce. Second, the Carriers should be precluded from challenging the reasonableness of intrastate rates because they have refused for several years to present cost-based tariffs compliant with Order 151 requirements to the RCA to show that applicable intrastate rates should be raised. Third, issuance of a Section 13(4) order would reward the Carriers for their "end-run" or "forum shopping" strategy of avoiding a negative outcome in Alaska's judicial system by effectively persuading FERC to overrule years of ratemaking orders by the authorities in Alaska and to act as the regulator of primary jurisdiction over Alaska's intrastate oil pipeline rates. Fourth, Supreme Court cases make clear that reasonable differences between federal and state ratemaking methodologies can and should be encouraged by FERC in that the ICA does not require uniformity between federal and state methodologies. Fifth, the Carriers are collaterally estopped from challenging intrastate rates on the basis of rejection of such challenges by the RCA and the Superior Court of Alaska. Sixth, in light of Section 13(3), any Section 13(4) order issued in the absence of joint federal and state regulatory proceedings may be deficient. Because granting the Carriers' Petition would bring about all these negative consequences without having submitted cost-based evidence demonstrating that the intrastate rates are deficient and that the interstate rates are not unnecessarily excessive, the Presiding Judge should reject it.

ARGUMENT

I. WHICH PARTIES BEAR THE BURDEN OF PROOF ON WHICH ISSUES?

The Carriers bear the Section 13(4) burden of proof. As interpreted by the Supreme Court, the petitioner's evidentiary burden must meet an exacting standard

requiring the petitioner to prove each element of a Section 13(4) claim, including but not limited to, the obligation to prove that the intrastate rates are abnormally low; that intrastate rates fail to make a fair contribution to revenue needs; and that intrastate rates impose an undue burden on interstate commerce or on interstate shippers. *See* Sections V.C and V.D herein for discussion of the stringent burden of proof. Because the Carriers failed to proffer cost-of-service evidence and probative evidence of injury to interstate commerce, they emphatically did not meet their high burden of proof under Section 13(4). The RCA takes no position on the burden of proof on issues other than the issues raised by the Section 13(4) Petition.

II. Should the TAPS Settlement Methodology (TSM) Be Used to Determine TAPS Rates?

A. What Is the Scope of this Issue?

The RCA has determined that TSM is not appropriate for *intrastate* ratemaking, which must be based on the actual cost of providing the intrastate service. (Order 151 at 23-55). The RCA takes no position regarding the use of TSM for *interstate* ratemaking.

B. What Legal/Regulatory Principles Apply?

Regarding intrastate rates, Alaska Stat. § 42.06.370(a) requires that intrastate pipeline rates must be "just and reasonable." The PCA has applied that statutory mandate by requiring that rates must be based on the actual cost of providing service, and that actual cost of service must be established before any non-cost factors are considered. (Order 151 at 11-12.) The RCA takes no position on this issue regarding interstate rates.

C. HAVE THE APPLICABLE STANDARDS BEEN SATISFIED?

With regard to intrastate rates, the RCA determined that applicable legal and regulatory standards were not satisfied. (Order 151 at 23-55.) The RCA takes no position on this issue as to interstate rates.

D. ARE THE RATES DETERMINED BY TSM JUST AND REASONABLE?

As stated above, the intrastate rates must be based on actual cost of service. The RCA determined that TSM rates are not just and reasonable for intrastate purposes. (Order 151 at 33-55.) The RCA takes no position on this issue regarding interstate rates.

E. DO THE TAPS CARRIERS' 2005 AND 2006 TAPS INTERSTATE RATES COMPLY WITH THE TAPS SETTLEMENT AGREEMENT?

The RCA takes no position on the Carriers' interstate rates.

III. IF TSM SHOULD NOT BE USED, WHAT METHODOLOGY SHOULD BE USED AND HOW SHOULD THAT METHODOLOGY BE APPLIED?

In Section V, the RCA explains why the TSM methodology is not cost based and fails to support the Carriers' Section 13(4) Petition to raise intrastate rates. The RCA takes no position on the cost-of-service methodology for the interstate rates.

IV. DO THE TAPS CARRIERS' 2005 AND 2006 TAPS INTERSTATE RATES COMPLY WITH SECTION 2 OF THE ICA, SECTION 3(1) OF THE ICA, AND SECTION II-11(E) OF THE TAPS SETTLEMENT AGREEMENT?

The RCA takes no position on this issue.

V. DO THE TAPS INTRASTATE RATES ESTABLISHED BY THE REGULATORY COMMISSION OF ALASKA VIOLATE SECTION 13(4) OF THE ICA, AND IF SO, WHAT IS THE APPROPRIATE REMEDY?[9]

No. As discussed below, FERC does not have jurisdiction to raise intrastate oil pipeline rates. On the merits, the Carriers fail to prove any of the five elements of a *prima facie* Section 13(4) case, and additional factors weigh strongly in favor of rejecting the Petition.

A. SECTION 13(4) DOES NOT AUTHORIZE FERC TO PRESCRIBE INTRASTATE OIL PIPELINE RATES.

Section 13(4) of the ICA did not confer jurisdiction on the ICC to establish intrastate rates for oil pipelines nor does it authorize FERC to do so. Congress added Section 13(4) to the ICA in 1920 for the limited purpose of allowing the ICC to establish intrastate rates for railroads to ensure that minimum total revenue requirements for railroads were achieved because railroads had been taken over by the federal government during World War I. In the legislation enacting Section 13(4), Congress did not address oil pipelines and did not authorize the ICC to set intrastate rates for oil pipelines.

The ICA was enacted in 1887, but the initial legislation gave the federal government no jurisdiction over the establishment of the rates for oil pipelines. Subsequently, Congress enacted the Hepburn Act, 34 Stat. 584 (1906), giving the ICC jurisdiction over the rates of oil pipelines only for interstate transportation, not for intrastate transportation.

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[9] The outline subheadings in this Section V of the Argument have been added to assist the Presiding Judge and the participants in following the structure of the RCA's Section 13(4) Argument.

During World War I, the Federal Control Act, 40 Stat. 451 (1918), authorized the federal government to take over the operation of "certain railroads and systems of transportation" for emergency purposes. The Federal Control Act provided for the compensation of the railroads at an annual sum not exceeding "its average annual railway operating income for the three years ended June thirtieth, nineteen hundred and seventeen." *Id.* The Federal Control Act did not authorize the federal government to take over the operation of oil pipelines.

The Transportation Act of 1920, 41 Stat. 456 (1920), was enacted "to provide for the termination of Federal control of railroads and systems of transportation." Section 200(a) of the Transportation Act of 1920 provides that Federal control "of all railroads and systems of transportation" shall terminate on March 1, 1920. Section 200(b) makes express reference to the termination of federal control of railroads or systems of transportation, boats, barges, tugs, and other transportation facilities on the inland, canal or coastwise waterways, and canals. The Transportation Act of 1920 gives no express authority to the ICC to establish intrastate rates for oil pipelines.

Section 416 of the Transportation Act of 1920 added Section 13(4) to the ICA, and Section 422 of the same legislation added Section 15a to the ICA.[10] As discussed below, Sections 13(4) and 15a(2) must be read in tandem. The purpose of these specific additions to the ICA was to ensure that railroads would be economically healthy, *i.e.,* that they would receive a minimum revenue requirement to recover their costs of operations and reasonable return on their invested capital, after Congress returned the operation of the railroads to private industry when World War I had ended. A review of the plain language of the relevant portions of the Transportation Act of 1920 and the Supreme Court cases interpreting Sections 13(4) and 15a make clear that Congress limited the ICC's authority under Section 13(4) to raising intrastate railroad rates and did not authorize the ICC to raise intrastate oil pipeline rates.

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[10] Congress amended Section 15a in 1933, but the amended version was also limited to railroads and the amendment is therefore not material to this FERC proceeding. Both the 1920 version of Section 15a(2) and the 1933 version of Section 15a(2) are set forth in Appendix A. Congress has amended Section 13(4) since its enactment in 1920 in ways that are not material to this proceeding. In its current version, Section 13(4) provides:

> (4) Duty of Commission where State regulations result in discrimination
>
> Whenever in any such investigation the Commission, after full hearing, finds that any such rate, fare, charge, classification, regulation, or practice causes any undue or unreasonable advantage, preference, or prejudice as between persons or localities in intrastate commerce on the one hand and interstate or foreign commerce on the other hand, or any undue, unreasonable, or unjust discrimination against, or undue burden on, interstate or foreign commerce (which the Commission may find without a separation of interstate and intrastate property, revenues, and expenses, and without considering in totality the operations or results thereof of any carrier, or group or groups of carriers wholly within any State), which is hereby forbidden and declared to be unlawful, it shall prescribe the rate, fare, or charge, or the maximum or minimum, or maximum and minimum, thereafter to be charged, and the classification, regulation, or practice thereafter to be observed, in such manner as, in its judgment, will remove such advantage, preference, prejudice, discrimination, or burden. Such rates, fares, charges, classifications, regulations, and practices shall be observed while in effect by the carriers parties to such proceeding affected thereby, the law of any State or the decision or order of any State authority to the contrary notwithstanding.

Shortly after the enactment of the Transportation Act of 1920, the Supreme Court had the opportunity to review the historical context and purpose of that 1920 legislation. In *R.R. Comm'n of Wisconsin v. Chicago, Burlington & Quincy R.R. Co.*, 257 U.S. 563, 582-84 (1922), the court summarized the history of the ICC's regulation of the rates charged by railroad carriers, the federal control over the railroads in World War I and the amendments to the ICA in 1920, including the addition of Sections 13(3), 13(4) and 15a to the ICA. The court noted: "The new measure [the 1920 Act] imposed an affirmative duty on the Interstate Commerce Commission to fix rates and to take other important steps to *maintain an adequate railway service for the people of the United States*. This is expressly declared in § 15a to be one of the purposes of the bill." 257 U.S. at 585, emphasis added.

After observing that twenty percent of the freight receipts and fifty percent of the passenger receipts of U.S. railroads came from intrastate service, the court then clarified (257 U.S. at 586) the "dovetail relation" between Section 15a and Section 13(4):

> If the railways are to earn a fixed net percentage of income, the lower the intrastate rates, the higher the interstate rates may have to be. The effective operation of the act will reasonably and justly require that intrastate traffic should pay a fair proportionate share of the cost of maintaining an adequate railway system. Section 15a confers no power on the Commission to deal with intrastate rates. What is done under that section is to be done by the Commission "in the exercise of its power to prescribe just and reasonable rates", i.e., powers derived from previous amendments to the Interstate Commerce Act, which have never been construed or used to embrace the prescribing of intrastate rates. When we turn to paragraph 4, § 13, however, and find the Commission for the first time vested with a direct power to remove "any undue, unreasonable, or unjust discrimination against interstate or foreign commerce", *it is impossible to*

> *escape the dovetail relation between that provision and the purpose of § 15a.* If that purpose is interfered with by a disparity of intrastate rates, the Commission is authorized to end the disparity by directly removing it, because it is plainly an "undue, unreasonable, or unjust discrimination against interstate or foreign commerce", within the ordinary meaning of those words. [Emphasis added.]

Thus Section 13(4) was added by Congress to permit the ICC to ensure that states would not prevent the railroads from achieving minimum national revenue requirements determined under Section 15a or cause interstate revenues to unreasonably subsidize intrastate railroad service.

As enacted in 1920, Section 15a(2) provided that the ICC shall ensure that "carriers" will "earn an aggregate annual *net railway operating income* equal, as nearly as may be, to a fair return upon the *aggregate value of the railway property* of such carriers…." [Emphasis added.] In *Florida v. United States*, 282 U.S. 194, 211 (1931) ("*Florida I*"), the Supreme Court again emphasized the "dovetail relation" between Section 13(4) and Section 15a:

> In construing the statute this Court has held that the general provision of section 13(4) prohibiting "unjust discrimination against interstate commerce" and authorizing the Commission to establish intrastate rates to prevent such discrimination, is to be read in connection with section 15a, both of which were added by Transportation Act, 1920 (secs. 416, 422, 41 Stat. 484, 488). There is what this Court has called a "dovetail relation" between the two provisions. *The authority granted by section 13(4) is thus to be considered in the light of the affirmative duty of the Commission to fix rates and to take other important steps to maintain an adequate national railway system.* [Emphasis added.]

The Court in *Florida I* made no reference to oil pipeline rates.

In *United States v. Louisiana*, 290 U.S. 70, 74-75 (1933) ("*Louisiana*"), the Supreme Court reiterated the linkage between Section 13(4) and 15a(2) (footnotes omitted):

> This Court has consistently held that this section [13(4)] is to be construed in the light of § 15a(2) and as supplementing it, so that the forbidden discrimination against interstate commerce by intrastate rates includes those cases in which disparity of the latter rates operates to thwart the broad purpose of § 15a to maintain an efficient transportation system by enabling the carriers to earn a fair return.

In the Emergency Railroad Transportation Act, 48 Stat. 211 (1933), Congress amended Section 15a(2) of the ICA.[11] The 1933 amendment is not material to the instant oil pipeline proceeding because amended Section 15a(2) is limited to railroad revenues, as was its 1920 predecessor.

In *Florida v. United States*, 292 U.S. 1, 8 (1934) ("*Florida II*"), the Supreme Court held that the 1933 amendment did not eliminate the ICC's power to raise intrastate rates pursuant to Section 13(4) and again emphasized the linkage between Section 13(4) and Section 15a to ensure the economic health of railroads: "The new Act discloses no intention to weaken national control for essential national purposes over *the railway system of the country*. It was rather designed to aid that control in the light of the depressed economic condition of *the railways*. We conclude that the new rule of rate making left the power of the Commission under § 13(4) intact." [Emphasis added.]

In his dissenting opinion in *Pub. Serv. Comm'n of Utah v. United States*, 356 U.S. 421, 431-32 (1958), *reh'g denied*, 357 U.S. 933 (1958) ("*Utah*"), Justice Frankfurter emphasized the supplementary relation between Sections 13(4) and 15a(2):

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[11] Section 15a(2) as amended in 1933 is also set forth in Appendix A of this brief.

> [T]he immediate purpose of the exercise of the Commission's power under this head [13(4)] is to assure to the carrier needed revenues. The test of what revenues are needed is found in § 15a(2) ... which instructs the Commission in prescribing rates to give due consideration to the need "in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management to provide such service."

Thus, Congress restricted the ICC's authority to raise intrastate rates to railroad rates, and the Supreme Court has consistently recognized that limitation on Section 13(4) by holding that Section 13(4) is directly tied to Section 15a(2).

In the fifty-seven years from the enactment of the Transportation Act of 1920 to the DOE Organization Act[12] in 1977 transferring jurisdiction over oil pipeline rates from the ICC to FERC, no ICC order has been found that raised intrastate oil pipeline rates pursuant to Section 13(4). The absence of such an order for fifty-seven years represents implicit recognition by the ICC that it lacked Section 13(4) authority over intrastate oil pipeline rates.

Federal agencies have only the jurisdiction granted to them by Congress. They do not have jurisdiction to nullify state regulation unless Congress has made its intention "clear and manifest" to grant such authority. As the Supreme Court summarized in *Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 449 (2005):

> Even if Dow had offered us a plausible alternative reading of § 136v(b)–indeed, even if its alternative were just as plausible as our reading of that text–we would nevertheless have a duty to accept the reading that disfavors pre-emption.

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[12] DOE Organization Act, 91 Stat. 565 (1977).

> "[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action." *Medtronic*, 518 U.S., at 485, 135 L. Ed. 2d 700, 116 S. Ct. 2240. In areas of traditional state regulation, we assume that a federal statute has not supplanted state law unless Congress has made such an intention "'clear and manifest.'" *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655, 131 L. Ed. 2d 695, 115 S. Ct. 1671 (1995) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 91 L. Ed. 1447, 67 S. Ct. 1146 (1947)); see also *Medtronic*, 518 U.S., at 485, 135 L. Ed. 2d 700, 116 S. Ct. 2240.

There is no evidence in the legislative history of Section 13(4), the Supreme Court cases interpreting that statute, or the ICC's case law of any "clear and manifest" intention of Congress to authorize the ICC to nullify state oil pipeline regulation in addition to providing such authorization regarding state regulation of railroads.

The DOE Organization Act did not expressly transfer Section 13(4) authority over oil pipelines to FERC. The House Conference Report No. 95-539, July 26, 1977, at 68-70, contains a list of ten ICC oil pipeline functions transferred to FERC but omits any reference to Section 13(4) authority. The statute that reenacted the transfer of authority of oil pipelines to FERC, 49 U.S.C. § 60502, omitted any reference to Section 13(4) authority.

The Carriers' Petition assumes without discussion or evidence that FERC has jurisdiction to raise intrastate oil pipeline rates under Section 13(4). The Petition cites only two cases in support of the alleged Section 13(4) authority, *King v. United States*, 344 U.S. 254 (1952), *reh'g denied*, 344 U.S. 936 (1953) ("*King*"), and *Louisiana, supra*, 290 U.S. 70. Both cases pertain to railroads, not oil pipelines, and both cases affirm the linkage between Sections 13(4) and 15a(2).

No decision by FERC has been found in which FERC exercised authority under Section 13(4) to raise intrastate oil pipeline rates.[13] The absence of any such Section 13(4) order directed to an oil pipeline in the eighty-seven years since the enactment of the Transportation Act of 1920 is no coincidence. As the above review of the relevant legislation and Supreme Court cases shows, Section 13(4) did not authorize the ICC or FERC to raise intrastate oil pipeline rates.[14] There is no "clear and manifest" Congressional intent to permit federal nullification of state oil pipeline regulation. Because FERC lacks jurisdiction to entertain the Carriers' Petition, the Presiding Judge should dismiss the Petition. However, if the Presiding Judge concludes that FERC has Section 13(4) jurisdiction to raise intrastate oil pipeline rates, she should reject the Petition on the merits as discussed below.

B. BACKGROUND REGARDING ORDER 151

The Carriers' Petition asks FERC to raise the intrastate rates established by the RCA to the level of interstate rates. (Petition at 18-19.) It is therefore appropriate for the Presiding Judge to examine the process and the substance of the orders by which the RCA established the intrastate rates the Petitioners challenge.

1. PROCEDURAL HISTORY

Order 151, issued November 27, 2002, was the culmination of a proceeding before the RCA that began six years earlier with the Carriers' 1996 filing of TAPS

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[13] *But see Cook Inlet Pipe Line Co.*, 47 FERC ¶ 61,057 (1989), *order denying reh'g and clarifying*, 47 FERC ¶ 61,393 at 62,307 (1989) ("Commission declined to make such determination under Section 13 because Cook Inlet specifically disclaimed relief under that section.").

[14] In Section V.D.6(F) below, the RCA explains that a Section 13(4) order issued without joint hearings as provided in Section 13(3) may be deficient in the circumstances of this case.

intrastate rates for calendar year 1997.[15] The Carriers, relying on the TSM incorporated in the 1986 Intrastate Settlement Agreement between the Carriers and the State of Alaska, filed TSM-based intrastate rates for 1997.[16] (Order 151, Section X, Endnote 2 at 5.)

Tesoro Alaska Company ("Tesoro"), a party in this FERC proceeding, protested the Carriers' intrastate rates before the RCA as unjust and unreasonable. (*Id.* Endnote 2 at 7.) The RCA set for hearing both the post-1996 rates to determine if they were just and reasonable (Docket No. P-97-4) and also DR&R collection and allowance issues (Docket No. P-97-7). (*Id.*, Endnote 2 at 7.) The Carriers challenged the RCA's initial decision to set intrastate rates for hearing, raising some of the same arguments raised in this proceeding, namely that select elements of the Intrastate Settlement Agreement (*e.g.*, DR&R costs, APB costs and other TSM elements) could not be reexamined without reopening all issues resolved in the settlement (the so-called "cherry picking" argument); and that a decision adjusting the intrastate rates below the interstate rate level could lead to an order by FERC under Section 13(4) invalidating the intrastate rate. (*Id.*, Endnote 2 at 7-8.) The RCA rejected the Carriers' initial challenge and conducted a full evidentiary hearing.

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[15] Order 151, Section X, Endnote 2 contains a detailed description of the events leading up to Order 151 and the procedural history of Docket Nos. P-97-4 and 7. Order 151 was received in evidence as Exhibit No. A/T-31 in this proceeding. The complete record of the Order 151 proceedings is in evidence in this FERC proceeding as Exhibit No. A/T-138. A basic chronology of the relevant orders is included in Appendix B. The citations to the page numbers of Order 151 in this Initial Brief are to the page numbers in the slip opinion of Order 151 itself and not to the pages of any exhibit or court record. The Lexis citation of Order 151 is 2002 Alas. PUC LEXIS 630 (Nov. 27, 2002).

[16] The Carriers' TSM-based intrastate rate filings for 1998, 1999 and 2000 were subsequently consolidated in Docket Nos. P-97-4 and -7. The TSM incorporated in the Intrastate Settlement Agreement is materially identical to the TSM incorporated in the Interstate Settlement Agreement for purposes of the issues addressed in this brief.

The Carriers filed their case-in-chief at the RCA on October 8, 1998, relying on their compliance with the TSM process in the Intrastate Settlement Agreement as sufficient to justify their rates. (*Id.*, Endnote 2 at 8.) However, the RCA agreed with Tesoro that the issue was not whether "TSM is a just and reasonable methodology" but whether the resultant rates were just and reasonable. (*Id.* at 9.) The RCA also took issue with the Carriers' failure to provide reasoned explanations for non-cost based TSM factors included in the filed rates. (*Id.*, Endnote 2 at 9.)

The RCA then gave the Carriers a *second* opportunity "either to file a case supporting their 1997-2000 filed rates as just and reasonable under the Alaska Stat. § 42.06 or to file different rates with support showing that the new rates were just and reasonable." (*Id.*, Endnote 2 at 10.) The Carriers chose to support their TSM rates much in the same way they do in this proceeding – by relying on higher benchmark rates, unsupported non-cost rate elements, and hypothetical depreciation that on its face is less than the actual depreciation recovered from customers through the Carriers' rates. (Order 151 at 34-55.) The RCA rejected TSM rates as unjust and unreasonable.

2. SUMMARY OF KEY FINDINGS AND CONCLUSIONS OF ORDER 151

Planning for the construction of TAPS began in 1968 and construction was completed in 1977 at an original cost of approximately $9 billion. (Order 151 at 2 and Exh. 3, Schedule 15, page 1.) From 1977 through 1996, the last unregulated year for intrastate TAPS rates, data prepared and filed by the Carriers to support their rates indicated that they incurred an additional $10.7 billion in expenses devoted to operating TAPS. (Order 151 at 45.) During that same period, the Carriers received a total of more than $50 billion in revenues from TAPS. (*Id.*) Thus, in raw terms, the Carriers

received revenues of approximately $30 billion more than the costs they incurred with respect to TAPS over that period. The RCA concluded that by 1997, applying an appropriate consistently applied depreciated original cost methodology, the TSM rates provided the Carriers the opportunity to earn over $9.9 billion in excess of the reasonable and prudent costs of providing service. (Order 151 at 8, 42.)

The RCA, in Order 151, determined that TAPS should be considered to have a $669 million year-end 1996 rate base for purposes of prospective ratemaking. (Order 151 at 8-9, 55-123.) It reached that conclusion by, *inter alia*, applying the DOC methodology from the beginning of TAPS operations (*id.* at 122-23); adopting what it found to be an appropriate hypothetical capital structure for TAPS of 49.5% debt and 50.5% equity (*id.* at 74-77); adopting the historical TSM depreciation charges, which reflected depreciation already recovered by the Carriers through their filed and collected rates (*id.* at 115-122); and setting overall annual rates of return ranging from 11 to 15 percent (*id.*, Exh. 2).

The RCA accepted the Carriers' inputs for a fundamental component of the rate calculations, their historical and continuing operating costs. (Order 151 at 156-57.) It also accepted the Carriers' positions concerning other rate-related matters: their "rolled-in barrel mile methodology" (*id.* at 156-60); their "property balances," including their capital expenditure amounts, their working capital, and property retirements (*id.* at 55-62, 148); and their TAPS throughput amounts (*id.* at 159-61). Had the RCA not accepted the Carriers' positions on these and other issues, the result would have been lower rates and larger refunds to the shippers.

The RCA also adopted various methodological approaches proposed by the Carriers and opposed by one or both of the shippers, including the approach to calculating the Allowance for Funds Used During Construction ("AFUDC"). (Order 151 at 113-15.) In addition, it adopted the Carriers' basic approach to rate design, as well as to other matters, on which the parties essentially agreed, including income taxes ("assuming the maximum statutory federal and state income taxes") and allocating costs between distance and non-distance related costs. (*Id.* at 157-160.)

Using the $669 million rate base as the starting point for determining just and reasonable rates for the years 1997 through 2000, the RCA determined that the intrastate rates filed and charged by the Carriers for those years were not just and reasonable, set just and reasonable rates for those years, and ordered that the Carriers pay the shippers appropriate refunds. (Order 151 at 132-168.)

C. ANY FERC AUTHORITY UNDER ICA SECTION 13(4) TO SUPPLANT AN RCA-PRESCRIBED INTRASTATE RATE IS NARROW AND SUBJECT TO STRINGENT PROCEDURAL AND EVIDENTIARY REQUIREMENTS.[17]

The Carriers' concession in the October 13, 2006 stipulation of issues that they bear the Section 13(4) burden of proof fails to present the full picture of their stringent evidentiary burden under that statute. The Supreme Court has articulated a formidable burden of proof that the Carriers must meet in order to justify their Section 13(4) Petition to raise intrastate rates. A Petitioner[18] cannot seek to invoke this Commission's authority under Section 13(4) without providing substantial evidence that supports a

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[17] If the Presiding Judge concludes that Section 13(4) does not authorize FERC to prescribe intrastate oil pipeline rates, the substantive points of this Initial Brief will be moot.

[18] Here the Carriers are the Petitioners and therefore have the burden of proving the required elements of a Section 13(4) case.

finding of "each of the elements essential to [the exercise of that] federal power." *Utah*, 356 U.S. at 425. The Court explained that the following findings, only if supported by substantial evidence, could be adequate to support an order under Section 13(4):

> (1) that existing intrastate rates were abnormally low and did not contribute a fair share of the railroads' revenue needs; (2) that conditions as to the movement of intrastate traffic were not more favorable than those existing in interstate commerce; (3) that the rates cast an undue burden on interstate commerce; (4) that the increase ordered by the Commission would yield substantial revenues; and (5) that such increase would not result in intrastate rates being unreasonable and would remove the existing discrimination against interstate commerce.

Utah, 356 U.S at 425-26, *citing King*, 344 U.S. at 267-68.[19] The Court in *Utah* held that these elements[20] of a Section 13(4) case were "inter alia" among the critical considerations, thus clarifying that additional factors bear on the case. *Utah*, 356 U.S. at 425; *see* Section V.D.6 below.

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[19] At page 57 of their October 16, 2006 Response to Anadarko *et al.*'s motion for summary jurisdiction, the Carriers cite *King* at 270, n.13 for essentially the same five key elements of a Section 13(4) case listed by the Supreme Court in *Utah*. The Carriers allege at 57-60 of their response that they provided proof of all five elements and conclude (at 60) that they therefore "have established a *prima facie* case" under Section 13(4). As the RCA demonstrates in this Section V of its brief, the Carriers have entirely failed to prove any of the five basic elements of a Section 13(4) case, and there are additional factors that weigh strongly against nullifying the Alaska intrastate rates at issue here.

[20] Regarding the elements of a *prima facie* Section 13(4) case, the court held in *Mississippi Pub. Serv. Comm'n v. United States*, 124 F. Supp. 809, 813 (S.D. Miss. 1954), *aff'd per curiam*, 349 U.S. 908 (1955) ("*Mississippi*"):

> In order to authorize the Commission to exercise the power to nullify intrastate rates under Section 13(4) of the Act, it must be shown, among other things, (a) that the intrastate rates involved are abnormally low and are not contributing to their fair share of the revenue of the carriers involved; (b) that the disparity between the rates is substantial and operates as a real discrimination against and obstruction to interstate commerce; (c) that injury to interstate shippers has resulted and will continue to result because of the disparity in rates; (d) that the proposed rates are just and reasonable; and (e) that a substantial increase in the carriers' revenue will result from the proposed increase in the intrastate rates. *State of North Carolina v. United States, supra.*

The stringency of the Section 13(4) evidentiary burden recognizes that FERC's broad ratemaking discretion is restricted to interstate rates and that no such "breadth of authority is granted to the Commission over purely intrastate rates" because states have "primary authority to regulate intrastate rates." *North Carolina v. United States,* 325 U.S. 507, 510-511 (1945) ("*North Carolina*"). These specific evidentiary burdens of the Section 13(4) Petitioner must be satisfied precisely because "[i]ntrastate transportation is primarily the concern of the State." *Utah*, 356 U.S. at 425-26.

A FERC order issued pursuant to Section 13(4) would constitute the "exercise of this exceptional federal power to interfere with intrastate rates." *Chicago, Milwaukee, St. Paul & Pacific R.R. Co. v. Illinois*, 355 U.S. 300, 306 (1958) ("*Chicago, Milwaukee*"). Therefore, evidence must be adduced by the Petitioners to support all required findings before preemption of a state order under Section 13(4) is permitted. *North Carolina*, 325 U.S. at 510.

The Supreme Court has repeatedly emphasized that petitions under Section 13(4) require an exceptionally high quality of evidentiary support. "The crucial question involved in all these contentions is whether the indispensable prerequisites to the exercise of the Federal Commission's power over intrastate rates have been shown to exist with sufficient certainty." *North Carolina*, 325 U.S. at 510. Such orders must meet "a high standard of certainty." *Illinois Cent. R.R. Co. v. Pub. Utils. Comm'n of Illinois,* 245 U.S. 493, 510 (1918). Before this Commission can nullify an intrastate rate established by a state commission, the justification for the "exercise of the federal power must clearly appear." *Florida I*, 282 U.S. at 211-212. The evidence must meet "the exacting standards required by our prior cases." *Utah*, 356 U.S. at 426.

A Petitioner who merely shows that interstate rates are higher than intrastate rates in essence shows absolutely nothing. Indeed, a Petitioner who shows only that just and reasonable interstate rates may be higher than intrastate rates has failed to make a *prima facie* case under Section 13(4). *North Carolina*, 325 U.S. at 514; *Utah*, 356 U.S. at 428 ("[r]ate uniformity is not necessarily the goal of federal regulation"). There must be proof not only that intrastate rates are low but that they are "abnormally low" and that they do not make a fair contribution to the pipelines' overall revenue requirement. *See Utah*, 356 U.S. at 425; *Mississippi*, 124 F. Supp. at 815. Furthermore, Section 13(4) prohibits FERC from "requir[ing] intrastate rates to be raised above a reasonable level." *Louisiana*, 290 U.S. at 78.

The *North Carolina*, *Utah* and *Mississippi* standards cannot be satisfied without cost-of-service evidence. Cost-of-service evidence is indispensable to any showing that the higher interstate rates are themselves just and reasonable; that any disparity between the inter- and intrastate rates is not reasonable; that the intrastate rates are "abnormally low"; that the intrastate rates fail to make an adequate contribution to the Carriers' total revenue requirement; or that the proposed increase in intrastate rates is reasonable. Having failed to submit substantial evidence of their actual cost of service, the Carriers' case is *per se* deficient and defective and incapable of supporting a Section 13(4) claim. In plain words, the Carriers are "out of court."

In *Utah,* the Court found that evidence submitted failed to demonstrate that the conditions associated with intrastate and interstate rates are the same; that the intrastate rates unduly burden interstate commerce; that any increase in intrastate rates the ICC might require would be substantial; and that such an increase would not result

in unreasonable intrastate rates. *Utah,* 356 U.S. at 425-29. The Carriers in this case too have left the record virtually bare on the key elements of a Section 13(4) case, and thus failed to meet their burden of proof and failed to provide the Presiding Judge any basis for issuing a favorable ruling on their Petition.

The Presiding Judge and FERC must consider the entire record, including the material portions of the RCA proceedings. For example, in *Mississippi*, 124 F. Supp. at 814, the court noted that "the record in this case demonstrates that the Mississippi Commission gave great study and investigation and heard much testimony before the Commission itself." The court further held: "The Court in reviewing an order of the Interstate Commerce Commission has the duty to study the entire record and it is the function of the Court to determine from the whole record whether or not there was substantial evidence before the Commission...." *Id.* It is important for purposes of evaluating the Section 13(4) Petition to consider Order 151, and the record of the RCA proceedings that is a part of the record in this FERC proceeding.[21]

Just as in the instant proceeding, the state commission in *North Carolina* had already conducted hearings and established intrastate rates. The Supreme Court reversed an ICC order raising intrastate rates, holding among other things:

> Neither in its formal findings nor in its discussion of the facts did the Commission indicate that the North Carolina railroad rates here involved were less than compensatory or insufficient to cover the full cost of service.

325 U.S. at 515. The Carriers, as proponents of the Section 13(4) Petition, have the burden of placing substantial evidence into the record upon which the FERC can make

[21] *See* Exh. A/T-138.

clear findings with "a high standard of certainty." *Illinois Cent. R.R. Co.*, 245 U.S. at 510. Among other things, FERC must be able to find through the hearing process that the RCA rates are abnormally low and do not contribute sufficiently to the pipelines' revenue needs; that the intrastate rates cast an undue burden on interstate commerce; and that the increase which FERC would order would be reasonable. *Utah*, 356 U.S. at 425-26.

The Supreme Court has consistently emphasized the requirement of substantial evidence needed to support findings made by the agency. *See, e.g., Utah*, 356 U.S. at 423 (ICC decision reversed because "certain findings of the Commission lack sufficient support in the evidence"); *Mississippi*, 124 F. Supp. at 815 (there is "no testimony in the record having probative force showing that the rates in Mississippi were abnormally low"); *North Carolina*, 325 U.S. at 520 ("without such findings supported by evidence, the Commission was not authorized" to find discrimination against interstate commerce). As Petitioners, the burden of proffering substantial evidence to support any and all required findings is squarely on the Carriers.

The RCA respectfully submits that FERC cannot make any relevant Section 13(4) findings based on this record since the only cost-of-service evidence in the record demonstrates that the intrastate rates are not abnormally low and that they do contribute fairly to the Carriers' revenue needs. (Exh. A/T-31, Order 151.) The record shows that the Carriers' intrastate rates are not discriminatory because they are cost justified and conversely that any increase in those rates above a cost justified level would not be reasonable. *Id.* Since the Carriers thus fail to meet their burden of proof,

the record of the FERC proceeding is incapable of supporting the required findings, and therefore the Presiding Judge must reject the Carriers' Section 13(4) Petition.

D. THE CARRIERS FAILED TO MEET THEIR STRICT BURDEN OF PROOF UNDER ICA SECTION 13(4).

As discussed above, the Carriers must show, among other elements of their Section 13(4) claim, that (1) existing intrastate rates are abnormally low and do not contribute a fair share of the Carriers' revenue needs; and (2) the intrastate rates cast an undue burden on interstate commerce. *Utah*, 356 U.S. at 425-26; *see also Mississippi*, 124 F. Supp. at 813, *citing North Carolina*. The Carriers failed to proffer clear, substantial evidence to show that either of these two critical conditions or any of the other conditions identified by *Utah* are satisfied.[22]

1. THE CARRIERS FAILED TO PROVE THAT INTRASTATE RATES ARE ABNORMALLY LOW AND NOT CONTRIBUTING THEIR FAIR SHARE TO OVERALL CARRIER REVENUE REQUIREMENTS.[23]

(A) AS A THRESHOLD CONSIDERATION, A FINDING THAT THE INTERSTATE RATES SHOULD BE REDUCED OR ARE NOT COST-BASED MOOTS THE CARRIERS' ICA SECTION 13(4) CLAIM.

The Carriers' ICA Section 13(4) case is entirely premised on the differential between TSM rates and the RCA's Order 151 rates.[24] The Carriers' witness Dr. Toof calculated the alleged "harm" to interstate commerce by simply subtracting the Order

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[22] In their October 16, 2006 Response to Anadarko *et al.*'s motion for summary disposition, the Carriers (at 57) state that the five "conditions" identified in *King* are "sufficient" to prove their case and then argue that they have proved each of the five conditions. As discussed below, the Carriers proved none of the conditions and, contrary to their own allegation (at 60), fail to prove a "*prima facie*" case under Section 13(4).

[23] The subheadings V.D.1, V.D.2, V.D.3, V.D.4 and V.D.5 track the five key elements of a Section 13(4) case as summarized by the court in *Utah*. There are further outline subheadings within each of these five subsections for structural and organizational purposes.

[24] *See, e.g.*, Petition at 13.

151 revenue requirement for intrastate service from the TSM revenue requirement for interstate service. (Toof, Tr. 1026:1-20.) Dr. Kalt does nothing more than adopt Dr. Toof's basic calculation of the alleged harm without attempting further quantification. (Kalt, Exh. ATC-4 at 64:6-12.)

If the Presiding Judge concludes as the RCA did in Order 151 that TSM rates are not cost-based, and adopts an interstate rate based on an original cost methodology and appropriate cost-of-service elements, then the disparity between interstate and intrastate rates may be immaterial or non-existent. This is because cost-based interstate rates will be reduced to approximately the level of or even below the intrastate rates. The absence of a material disparity between intrastate and interstate rates will eliminate the Section 13(4) claim because the intrastate rate could not then be abnormally low and non-compensatory.

(B) THE CARRIERS FAILED TO OFFER SUBSTANTIAL COST-BASED EVIDENCE DEMONSTRATING THAT INTRASTATE RATES ARE ABNORMALLY LOW AND NON-COMPENSATORY.

With regard to the merits of the first critical element of a *prima facie* Section 13(4) case, the Carriers offered no substantial evidence that the RCA-set intrastate rates are abnormally low and that revenue produced from those rates does not contribute a fair share of Carriers' costs. Specifically, the Carriers offered no analysis whatsoever of the RCA's Order 151 or the underlying facts and law and cost-of-service evidence supporting that order. (Overcast, Exh. A/T-93 at 33:18-34:5.) The Carriers offered no cost-of-service study of their own showing the level of and differentiating intrastate and interstate costs to develop jurisdictionally relevant rates. (Overcast, Exh. A/T-93 at 32:15-18.) The Carriers failed to offer any evidence that "demonstrates that the RCA

rates deny the TAPS Carriers an opportunity to recover their costs of providing service." (Overcast, Exh. A/T-159 at 13:4-5.) The Carriers' complete failure to proffer cost-based evidence to show why the Order 151 rates do not allow them to recover their actual cost of providing service shows that the Carriers have failed to meet the first required element of their case.[25]

To meet their burden of proof regarding the first required element of their Section 13(4) case, the Carriers had to prove by cost-of-service evidence that the intrastate rates do not cover a fair share of the total revenue requirement. *North Carolina*, 325 U.S. at 514-15. These costs consist of "the earnings required to meet maintenance and operating costs and to yield a fair return on the value of property directed to transportation service both interstate and intra-state." *North Carolina*, 325 U.S. at 520, *citing Louisiana*, 290 U.S. at 75.

Instead of attempting to demonstrate that intrastate rates are abnormally low and non compensatory, the Carriers merely rely to their detriment on the above-described calculation of a disparity between intrastate and interstate rates as computed using TSM. However, absent cost-of-service evidence that the intrastate rates fail to recover intrastate costs, the Carriers have not proved that the intrastate rates are abnormally low or fail to fairly contribute to the Carriers' revenue requirement.

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[25] *See, e.g.*, Opinion No. 154-B, *Williams Pipeline Co.*, 31 FERC ¶ 61,377 at 61,833 (1985) ("it is evident that oil pipeline rates as a general rule must be cost-based.").

(C) THE CARRIERS FAILED TO OFFER A TAPS COST OF SERVICE AND PROPOSED AN OPINION 154-B ANALYSIS USING INCORRECT DEPRECIATION RESERVES AND AN INFLATED RATE BASE.

As discussed in this Section V.D.1(C), the calculation of accumulated depreciation is one of the most critical issues in evaluating the reasonableness of the Order 151 intrastate rates. Use of the correct depreciation methodology will show that Order 151 rates are fully compensatory for purposes of the Section 13(4) claim.

(1) THE RCA USED ACTUAL HISTORICALLY RECOVERED DEPRECIATION TO DETERMINE DEPRECIATION RESERVE AND NET RATE BASE.

The RCA (Order 151 at 35) recognized that the most critical issue resolved by Order 151 was the determination of the depreciation actually collected in rates through December 31, 1996 and the cost of depreciation on a going forward basis from and after January 1, 1997.

In arriving at the $669 million net plant in service value as of December 31, 1996, the RCA took the Carriers' capital expense figures and subtracted the depreciation actually collected in rates from 1977-1996 (Order 151 at 118-19, footnotes omitted):

> To set depreciation charges for 1977-1996, we determine the opportunity that the Carriers have enjoyed to recover their investment. We found that the TSM and TSM-6 depreciation amounts better represent this opportunity than the Carriers' FERC Form 6 books and records. To be consistent, we add the $450 million rate base exclusion to the TSM and TSM-6 depreciation charges for 1978-1984. The yearly amounts that we adopt for depreciation and accumulated depreciation used to determine the year-end 1996 rate base are set forth in Exhibit 22.

The choice of a depreciation schedule with correct inputs was necessary to provide "the Carriers with an opportunity to recover their capital investment and also [not to] force shippers to pay for that investment twice." (Order 151 at 36.) The RCA found that the

depreciation schedule that has actually been used, *i.e.*, the TSM depreciation schedule, was the best choice to satisfy those two objectives. (*Id.*)

The RCA separately determined historical depreciation charges (through year-end 1996) and current depreciation charges from 1997 through 2000. (Order 151 at 17.) The RCA recognized that a depreciation schedule for TAPS had never been approved by the RCA for purposes of establishing specific just and reasonable intrastate rates and that the Carriers' proposal not to recognize actual historical depreciation accruals was inappropriate. (Order 151 at 16-18.) The RCA specifically rejected the Carriers' reliance on a 1982 joint depreciation stipulation, finding that it was "not relevant to establishing a year-end 1996 rate base" and that it was superseded by the Intrastate Settlement Agreement. (Order 151 at 54.) A careful review of Order 151 shows that the RCA correctly calculated the beginning rate base as of December 31, 1996 and that FERC should not nullify the RCA's determination using Section 13(4).

(2) CONTRARY TO THEIR CLAIM HERE, AS OF 2005, THE CARRIERS HAD RECOVERED ALMOST ALL OF THEIR DEPRECIATION CHARGES.

The Carriers claimed before the RCA that depreciation charges had recovered only 54% of the TAPS' initial investment. (Order 151 at 35.) However, the Carriers' calculation did not reflect actual depreciation rate recoveries and was based on hypothetical prior-period recoveries at depreciation accrual rates substantially below the level actually charged pursuant to the TSM rates. The RCA found that the TSM depreciation schedule, applied from 1977-1996, showed that approximately 97% of the Carriers' investment had been recovered as of December 31, 1996. (Order 151 at 35.)

In the period 1997-2005, TSM rates permitted the Carriers to recover even more of their plant investment.

The RCA (Order 151 at 38-40) carefully considered the Carriers' arguments for using for purposes of calculating the depreciation reserve and net plant hypothetical depreciation rates that are substantially less than the depreciation charges recovered from customers under the Carriers' actual rates. In rejecting the Carriers' position, the RCA found (Order 151 at 39, emphasis added):

> There is no dispute in the record about the amount of depreciation that has been charged for the last twenty years under the rates calculated using TSM. Principles of equity and fairness require us to base our finding on the amount of depreciation that the shippers have been charged to date when we are determining the year-end 1996 rate base. In setting rates for 1997 through 2000, *we must insure that shippers do not pay twice for the same Carrier investment*.

Plain and simple, none of the Carriers' depreciation arguments advanced before FERC holds water for purposes of nullifying Order 151 rates pursuant to Section 13(4). Back when the TSM settlement was initially approved by the predecessor of the RCA (the APUC), the Carriers made the explicit representation to the APUC that TSM depreciation recovered the cost of capital investment. (Order 151 at 117.) In fact, the Carriers explicitly stated in their brief to the APUC that the TSM depreciation rate was intended to recover capital investment on an accelerated basis "in the early years of the pipeline's life" (Order 151 at 37). Now that their capital investment has been almost completely recovered, the Carriers cannot contend that TSM depreciation was not intended to recover their actual investment in TAPS.

In fact, the Carriers' prior representations that they were recovering accelerated depreciation embody the elements of equitable estoppel, precluding any claim by them

that depreciation was not recovered on an accelerated basis. The United States Supreme Court has described the principle of equitable estoppel as follows:

> The vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden. It involves fraud and falsehood, and the law abhors it. This remedy is always so applied as to promote the ends of justice. It is available only for protection and cannot be used as a weapon of assault. It accomplishes that which ought to be done between man and man, and is not permitted to go beyond this limit. It is akin to the principle involved in the limitations of action, and does its work of justice and repose where the statute cannot be invoked.

Dickerson v. Colgrove, 100 U.S. 578, 580-81 (1879), as quoted in *Sierra Pacific Power Co.*, 94 FERC ¶ 63,019 at n.336 (2001). The Carriers' actions satisfy each criterion. The Carriers knowingly and with premeditation represented to the APUC that the accelerated depreciation was intended to recover a major portion of their investment during the early years of the pipeline's service life. They made this representation to induce the APUC to accede to their proposal for a TAPS intrastate rate settlement, which was ultimately approved by the APUC. (Order 151 at 36-38.) The Carriers now seek to backslide from that representation, but as the Supreme Court stated, "[s]uch a change of position is sternly forbidden." *Dickerson*, 100 U.S. at 580-81.

To the extent that Alaska law may control, the Carriers would plainly be estopped from reversing their position on accumulated depreciation by the doctrine of quasi estoppel. Quasi estoppel "precludes a party from taking a position inconsistent with one he has previously taken where circumstances render assertion of the second position

unconscionable."[26] Reliance is not an essential element of quasi estoppel.[27] Nevertheless, there was such reliance as discussed above because the APUC relied on the Carriers' representations about accelerated depreciation methodology.

Intrastate shippers, none of whom were parties to the settlement agreements, could not have known that Carriers would twenty years later argue that "accelerated depreciation" was not really accelerated depreciation. Now that the investment has been recovered from customers who have relied on and paid the rates formulated under the settlement agreements, the Carriers seek to disclaim their representation that the depreciation rates they actually charged did not recover their pipeline investment on an accelerated basis. In considering the Carriers' Section 13(4) claim, the Presiding Judge should reject the Carriers' use of their version of accumulated depreciation, which would result in double recovery of their investment and unjust enrichment at the expense of state jurisdictional customers and the state's oil consumers who would ultimately absorb these unjust costs.

The Carriers' claim also disregards the plain language of the settlement agreement, which states that its depreciation schedule "was intended to and has been used to recover investment." (Order 151 at 38.) Thus, the Carriers' depreciation claim violates the explicit language of the settlement, explicit representations made by the Carriers to induce APUC approval of their rates, and the actual history of the Carriers' recoveries of depreciation charges over the life of their prior rates for transportation

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[26] *Jamison v. Consol. Utils., Inc.*, 576 P.2d 97, 102 (Alaska 1978) (footnote omitted); *see also Dressel v. Weeks*, 779 P.2d 324, 330-31 (Alaska 1989).

[27] *See Dressel*, 779 P.2d at 331 ("In contrast to equitable estoppel, quasi estoppel 'does not require ignorance or reasonable reliance as essential elements.'").

service. For purposes of Section 13(4), the Carriers' unsupported depreciation theories should be rejected as a means of showing that intrastate rates are abnormally low and non-compensatory.

(3) DETERMINING THE ACTUAL DEPRECIATION COLLECTED IN CARRIERS' RATES IS NEITHER PIECEMEAL RATEMAKING NOR CHERRY PICKING.

The RCA rejected the Carriers' contention that the depreciation component of TSM cannot be separately identified. (Order 151 at 38-39.) The Carriers contended before the RCA that TSM can only be considered as an inseparable package; that none of its elements has regulatory significance outside the context of the settlement; that TSM depreciation is not actual depreciation; that only the complete package of the settlement produced a reasonable opportunity to recover their investment; and that isolating the TSM depreciation schedules constituted "cherry picking" of the settlement. (*Id.*)

The RCA did not engage in cherry picking or piecemeal ratemaking. To the contrary, the Order 151 rates are based on evidence that encompassed every aspect of the Carriers' costs. The "cherry picking" argument lacks credibility in light of the RCA's finding that TSM rates "provided the Carriers with an opportunity to recover $9.9 billion more than their costs as determined by the DOC revenue requirements." (Order 151 at 131, footnote omitted.)

Determining the level of prior depreciation charges in order to ascertain the proper level of depreciation reserve for current and future rates is not piecemeal ratemaking. In this instance, we know the amount of TAPS depreciation recovered through the depreciation schedule used in the TSM filings. The actual TAPS

depreciation charges were set forth in the filings, and the TSM rates recovered those depreciation charges. There is no disputable material fact regarding these prior depreciation recoveries and no legal basis for ignoring those recoveries in considering the Carriers' Section 13(4) claim.

(4) THE CARRIERS' PROPOSAL TO RECOVER PAST REVENUE INSUFFICIENCIES IN FUTURE RATES VIOLATES THE FILED-RATE DOCTRINE.

The Carriers' depreciation claims are in essence a request for prohibited retroactive ratemaking and for prohibited present subsidies to make up for past, alleged revenue deficiencies.[28] Without a sliver of evidentiary support, they imply that other components of the TAPS settlement rate were inadequate, but that they accepted those inadequate components in light of the higher depreciation charges. The Carriers have no basis for asking the RCA or the FERC to turn a blind eye to their past revenue collections including their collections for depreciation, which, in their own words, were designed to "recover a major portion of their capital investment in the early years of the pipeline's life." (Order 151 at 37.)

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[28] *City of Piqua, Ohio v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979) ("[T]he rule against retroactivity is a cardinal principle of ratemaking: a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle.") (internal edits omitted); *see also Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-52 (1951) ("We hold that the right to a reasonable rate is a right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."); *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 578-79 (1981) ("In sum, the Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission and prevents the Commission itself from imposing a rate increase for gas already sold."). *See also* ICA §6(7) (adopting filed rate doctrine's principal against retroactive ratemaking for oil pipelines), *Louisville & Nashville R.R. Co. v. Maxwell*, 237 U.S. 94, 97 (1915), and *Frontier Pipeline Co. v. FERC*, 452 F.3d 774, 788 (D.C. Cir. 2006) ("ICA § 6(7) ... establishes the familiar filed rate doctrine, i.e., the rule that a carrier may charge no more than the filed rate even if that rate is lower than the maximum just and reasonable rate").

Recognition of prior depreciation accruals in setting the rate base is consistent with a long line of Commission precedent.[29] The Carriers are asking for nothing less than double recovery of depreciation charges. FERC is especially careful to prohibit double recovery of depreciation charges to protect a regulated entity's customers. The issue frequently arises when a regulated entity attempts to change depreciation methodologies, for example from a net plant non-levelized methodology to a levelized gross plant methodology, and the FERC often denies applications to change depreciation methodologies on the ground that the change would cause over-recovery of return on and of capital.[30] This FERC policy prohibiting over-recovery of depreciation costs and thus over-recovery of return on and of capital is fully consistent with Order 151's insistence that the Carriers recognize their past actual depreciation recoveries prior to December 31, 1996 in developing depreciation reserve and net plant. A Section 13(4) nullification of Order 151 would therefore be *inconsistent* with FERC policy by

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[29] *Southern Natural Gas Co.*, 72 FERC ¶ 61,322 at 62,372-73 (1995) (ordering utility to conform its accounts with the depreciation rates and levels provided for in a prior settlement, stating "In general, depreciation has a unique ability to affect future rate cases. Depreciation expense becomes part of depreciation reserve which is then used to calculate net plant for return purposes."); *Yankee Atomic Elec. Co.*, 59 FPC 932 (1977) (applying remaining life method of depreciation and noting that failure to reflect in current rates actual depreciation calculations using the remaining life method would provide utility the benefit of accelerated capital recovery at the expense of customer's paying higher rates during the accelerated period); *Southwestern Pub. Serv. Co.*, 83 FERC ¶ 61,138, at 61,622-24 (1998) ("Absent explicit language in the settlements (or the Commission orders approving the settlements) that specifies depreciation rates other than those filed, [the utility] is required to book the filed depreciation rates," citing cases); *Sea Robin Pipeline Co.*, 54 FPC 2717 (1975) (ordering utility to file revised tariff sheets reflecting cost of depreciation actually booked since inception of company); *Mun. Light Bds. of Reading and Wakefield v. Boston Edison Co.*, Order on Rehearing, 54 FPC 440 (1975) ("Opinion No. 729-A") (requiring rates to be calculated on original plant investment net of prior depreciation using the remaining life method), *aff'd, Towns of Norwood v. FPC*, 546 F.2d 1036, 1038 (D.C. Cir. 1976) (affirming the use of remaining life method of depreciation to correct for excess past depreciation).

[30] *See, e.g.*, Opinion No. 434, *Maine Pub. Serv. Co.*, 85 FERC ¶ 61,412 at 62,564 (1998) (denying change because the change "will allow Maine Public to recover anew depreciation expense that it has already recovered, and therefore overrecover its transmission revenue requirement"); Opinion No. 432, *Kentucky Utils. Co.*, 85 FERC ¶ 61,274 at 62,103 (1998) (change denied because it "would lead to an over-recovery of costs").

allowing double recovery of depreciation costs and an excessive return on and of capital.

In this instance, the Carriers have asked the FERC to override the RCA's rate determination regarding accumulated depreciation, which happens to be in full conformity with FERC's own precedent. Thus, the Carriers' claim fails on several fundamental levels. First, their claim violates basic FERC ratemaking policy. Second, their claim seeks to override a state regulatory decision by reliance on ratemaking policies which FERC itself does not follow. Third, the Carriers disregard the words of the settlement agreement and their representations to Alaska regulatory authorities as to the nature of their depreciation recoveries. Fourth, they ignore the very depreciation revenues they have collected from customers under historically charged rates. To use the vernacular, the critical depreciation aspect of the Carriers' Section 13(4) claim does not have a leg to stand on and is frivolous.

(D) MERE COMPARISON OF RCA INTRASTATE RATES TO TSM-BASED INTERSTATE RATES AND DEFECTIVELY COMPUTED OPINION 154-B RATES IS INSUFFICIENT TO ESTABLISH THE FIRST CRITICAL ELEMENT OF A SECTION 13(4) CASE.

(1) A MERE COMPARISON OF INTRASTATE RATES TO TSM RATES IS IRRELEVANT TO A SECTION 13(4) CLAIM.

The Carriers compare the interstate TSM-based rates against the intrastate rates and summarily conclude that intrastate rates that are approximately 50% of interstate rates automatically result in under-contribution. (Petition at 14; Kalt, Exh. ATC-4 at 61:4-7.) This is a fundamental error. The Court held in *North Carolina*, 325 U.S. at 512, that such a conclusion is error because a mere comparison of intrastate and interstate

rates is insufficient *per se* to establish a Section 13(4) claim, which requires evidence and analysis of the impact of intrastate rates.

The Carriers' rate comparison also fails because it relies on the false conclusion that the rates used to develop the TSM-based interstate rates reflect the Carriers' actual cost of service. The TSM-based interstate rates have never been adjudicated to be just and reasonable and cost-based; they are the result of a settlement entered into between the State and the Carriers (Order 151, Endnote 7 at 21) and are now, for the first time in twenty years, being challenged at FERC. Therefore, there is no FERC-determined, cost-based revenue requirement to demonstrate that intrastate rates do not produce a fair share of the overall revenue requirement.

The only cost-based rates found to be just and reasonable are the intrastate rates approved by the RCA and the Carriers have failed to show that Order 151 is in any way flawed. (Brown, Exh. A/T-78 at 74:4-10.) Those intrastate rates are consistent with the same general legal principles routinely relied upon by FERC and are fully compensatory. (Brown, Exh. A/T-78 at 70:10-15.) The RCA "permitted the Carriers to recover all of their normalized operating costs for the test year in setting rates. The RCA also applied a depreciable original cost methodology and permitted the Carriers to recover a reasonable return on their remaining investment." (Overcast, Exh. A/T-93 at 34:7-10.)

In setting just and reasonable intrastate rates, the RCA applied the standard that such rates must

> generate enough revenue to pay the costs actually and prudently incurred by the regulated entity in providing service (including depreciation and taxes) plus a reasonable return to the entity on the original cost of its property in service.

Order 151 at 12, *quoting Re Kenai Pipeline Co.*, 12 APUC 425, 433 (Alaska P.U.C. 1992). A careful review of Order 151 will show that the intrastate rates are set correctly, are fully compensatory, and should not be nullified by a FERC order under Section 13(4).

In their Petition (at 15 n.35), the Carriers mistakenly rely on *King*, 344 U.S. 254, *supra*, to suggest that the disparity in rates establishes that the RCA-set intrastate rates do not recover a fair share of costs. The *King* decision fails to support the Carriers in the instant case. Although it addressed Section 13(4), the Court in *King* addressed the issue of whether the ICC could consider deficiencies in railroad passenger revenues as compared to freight revenues when setting rates. *Id.* at 276. Relying on particularized ICC findings that significant deficiencies in interstate rail-passenger revenues burdened interstate freight revenues, the Court affirmed the ICC's finding that the same relationship to these two services (freight and passenger) also applied to intrastate service. *Id.* at 267. That issue – the economic relationship between two different types of services – is not the issue presented here.

Of even greater importance, the specific ICC findings relied upon in *King* included a finding that rail-carriers were experiencing significant revenue deficiencies resulting from declining interstate passenger service. *Id.* at 274. These findings were the result of investigative reports developed by the ICC in cooperation with and endorsed by state commissioners. *Id.* at 257-58 and 274. In contrast, there has been no finding by either FERC or the RCA that the Carriers have experienced significant revenue deficiencies. To the direct contrary, the RCA concluded that TSM rates allowed the Carriers the opportunity to *over-recover* costs by $9.9 billion (Order 151 at

8), and the Carriers have offered no evidence of significant revenue deficiencies or declining profitability other than to compare the intrastate and TSM-set interstate rates and conclude that there is a $38 million difference – evidence that is not the result of a FERC investigation, is not supported by the RCA, and does not rise to the level endorsed by any state commissioner or relied upon by the ICC or the Court in *King*.

(2) COMPARISONS OF RCA INTRASTATE RATES TO VAN HOECKE OPINION 154-B BENCHMARK RATES ARE NEITHER PERSUASIVE NOR RELEVANT.

The Carriers incorrectly compare their witness Van Hoecke's Opinion 154-B benchmark analysis to the RCA-set intrastate rates in the hope of demonstrating undue discrimination. (Kalt, Exh. ATC-4 at 62:11-12.) This Opinion 154-B analysis results in a rate even higher than their filed TSM-based interstate rates. (Kalt, Exh. ATC-4 at 62:11-14.) This comparison fails, among other reasons, because the Carriers' Opinion 154-B analysis uses the wrong depreciation accrual and depreciation reserve that fail to take account of the TSM accelerated depreciation that has actually been collected in interstate rates and reported by the Carriers for 20 years. The comparison is also defective because it includes other unjustified non-cost components like the APB charge and a SRB adjustment, which grossly inflate costs and property balances in the rate base. (Overcast, Exh. A/T-159 at 13:4-14:14.) The deficiencies of the Carriers' Opinion 154 analysis are described in detail in Exhibits including A/T- 3, 52, 78 and 140.

The Carriers unsuccessfully employed the same strategy in the RCA proceeding – attempting to use a benchmark with incorrect inputs to justify a lower but still unjust and unreasonable TSM-based rate:

> It seems intuitive that if one adds additional costs to the revenue requirement in the federal jurisdiction by inflating

> rate base, recovering depreciation expense [that was] previously recovered and adding back to rate base dollars previously amortized, the resulting costs for intrastate service from the federal cost study must exceed state rates. *The under recovery arises from a flawed cost analysis, not inadequate state rates.*

(Overcast, Exh. A/T-159 at 14:7-12, emphasis added.) In this regard, one of the Carriers' own witnesses acknowledged during cross examination that the Opinion 154-B rate was so high and difficult to collect that his company would "choke" if it filed such a rate. (Barnaby, Tr. 2567:3-23.)

Although benchmarking is never an acceptable substitute for cost-of-service ratemaking, the Carriers' reliance on benchmark rates (an Opinion 154-B rate and a SAC rate) is misplaced. Benchmarking can cut both ways and here cuts against the Carriers. In this Section 13(4) proceeding the Carriers have the burden to demonstrate that their proposed intrastate rates are just and reasonable.[31] Anadarko and Tesoro also have offered an Opinion 154-B analysis based on *correct* cost inputs as opposed to the Carriers' *incorrect* inputs that have already been rejected by the RCA. Since the Carriers' benchmark rates exceed both the TSM-based rates and the Anadarko/Tesoro's Opinion 154-B rate, according to the Carriers' own theory FERC could as easily conclude that the Anadarko/Tesoro Opinion 154-B rates are the correct just and reasonable rates and should be used as the proper comparison with Order 151 rates. If the Anadarko/Tesoro Opinion 154-B rates are used as the benchmark, then the Carriers' TSM rates are not just and reasonable.

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[31] *See* Joint Stipulation of Issues (corrected October 13, 2006) at 2 (Carriers' acknowledge they bear the burden to demonstrate rates are just and reasonable).

As noted in Order 151, the D.C. Circuit rejected the use of benchmarks as a methodology for establishing just and reasonable rates:

> The D.C. Circuit Court of Appeals explained to the FERC quite clearly that approving rates that fall below a cap is not an acceptable way to set just and reasonable rates. The D.C. Court stated that setting a ceiling in that case only served as a cap on egregious price exploitation by regulated pipelines; it did not properly set just and reasonable rates.

Order 151 at 34, *citing Farmers Union Cent. Exch., Inc. v. FERC,* 734 F.2d 1486, 1502 (D.C. Cir. 198).

The Carriers offered no cost-of-service study to establish under-recovery or inadequate returns, and no evidence at all demonstrating flaws in Order 151 or the Alaska Superior Court's decision affirming Order 151. They have failed to prove, let alone with a "high standard of certainty," that that the intrastate rates are abnormally low and that they do not contribute a fair share to the Carriers' costs. Thus they failed to prove the first critical element of their Section 13(4) claim that their evidence proves that intrastate rates are "abnormally low." They rely solely on comparisons between the RCA-set rates and the Carriers' TSM rates and then their Opinion 154-B benchmark – comparisons that courts and the RCA have discounted. In contrast, using generally the same cost-based legal principles upon which FERC relies, Order 151 clearly establishes intrastate rates that are just, reasonable and fully compensatory of the Carriers' actual costs of providing intrastate service. FERC should not substitute the non-cost-based TSM rates for those cost-based Order 151 rates.

2. THE CARRIERS FAILED TO SHOW THAT CONDITIONS AS TO THE MOVEMENT OF INTRASTATE TRAFFIC WERE NOT MORE FAVORABLE THAN THOSE EXISTING IN INTERSTATE COMMERCE.[32]

The RCA did not proffer evidence on this issue. As discussed in Section V.D.6(D) below, the Supreme Court has recognized that states have the right to adopt ratemaking methodologies that are different from those used by the federal agency even where conditions of service are similar. The Carriers fail to show why FERC should use Section 13(4) to deprive the RCA of a right to a cost-based methodology consistent with Alaska law.

3. THE CARRIERS FAILED TO PROVE THAT INTRASTATE RATES CAST AN UNDUE BURDEN ON INTERSTATE COMMERCE OR ON INTERSTATE SHIPPERS.

With regard to the third key element of their case, the Carriers failed to show that the intrastate rates have resulted in any discrimination against, or obstruction to, interstate commerce or interstate shippers. They have not demonstrated that non-carrier affiliated Alaska refineries (1) materially compete outside Alaska; (2) have increased their use of ANS crude as a result of the RCA-set intrastate rates; or (3) through their use of ANS crude have caused West Coast refineries to invest billions of dollars for upgrades to process alternative crudes. The Carriers' assertions that interstate commerce has been harmed by the RCA's intrastate rates are based on mere generalizations with no evidentiary support. (Overcast, Exh. A/T- 93 at 35:10-18.) This failure of proof is fatal to the Carriers' case.

As a threshold matter, the Carriers' failure to proffer cost-of-service evidence is fatal to their claim that intrastate rates discriminate against interstate commerce or

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[32] This is the second element of a Section 13(4) case identified in *Utah*.

shippers. To conclude that a cost-based rate is discrimina[illegible], FERC must initially examine the cost-of-service used to derive the rates at issue.[33] In *Alabama Electric Co-op., Inc.*, 684 F.2d 20, 27 (D.C. Cir. 1982), the court in addressing a claim of rate discrimination held:

> [I]t has come to be well established that electrical rates should be based on costs of providing service to the utility's customers, plus a just and fair return on equity. FERC itself has stated that "[i]t has been this commission's long standing policy that rates must be cost supported...."

Id. at 27, quoting Carolina Power & Light Co., Docket No. ER76-495, By Direction Letter (Oct. 2, 1979). The court explained that even where the discrimination claim was based on two customer groups receiving substantially similar service, the gravamen is whether "the costs of providing service to one group are different from the costs of serving the other...." *Id.*

Since the Carriers have offered no probative cost-of-service evidence related to providing intrastate service, the Carriers have failed to make the required foundation for their claim that intrastate rates discriminate against interstate commerce or interstate shippers. Stated another way, an intrastate rate that fully recovers the actual costs of intrastate service cannot discriminate against interstate commerce.

(A) THE CARRIERS FAILED TO SHOW THAT INTRASTATE SHIPPERS MATERIALLY COMPETE IN AND COULD MATERIALLY AFFECT INTERSTATE COMMERCE.

Carrier witness Kalt's unsupported theory (Exh. ATC-4 at 64-65) that Alaska refineries compete with West Coast refineries because they "export[] some refined

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[33] *See The Potomac Edison Co.*, 56 FPC 3179 (1976) (explaining that not all rate distinctions are prohibited, but only those "as between customers of the same class, and then only undue discrimination – that which is not justified by differences in cost of service, operating conditions or other such considerations").

gasoline..." fails to prove that Alaska refineries compete with West Coast refineries or have any effect on relevant United States markets. The non-Carrier affiliated refineries located in Alaska that use TAPS-delivered ANS crude are in a different market from refiners located outside Alaska (*e.g.*, West Coast and Hawaii). In contrast to the markets served by West Coast refineries, the vast majority of petroleum products refined by the non-Carrier affiliated refineries are consumed within Alaska. (Sanderson, Exh. FHR-2 at 4-6.)[34]

Competition by refineries not affiliated with the Carriers against other suppliers of refined products in the non-Alaskan markets is *de minimis* when compared to the aggregate volumes of refined products sold on the West Coast. (*Id.*) Flint Hills' witness Sanderson established that, of the three refinery owners in Alaska, the Tesoro refinery is the primary exporter of finished light products and that Tesoro's exports are limited to less than 30% of Tesoro's total shipments. (Sanderson, Exh. FHR-2 at 9:10-20.) These shipments represent no more than 0.2% of total West Coast refining capacity and 0.2% of total finished light products on the West Coast. (Sanderson, Exh. FHR-2 at 10:1-6.)

According to Anadarko/Tesoro witness Dr. Overcast, the Tesoro refinery in Alaska accounts for only "2.3 percent of the total refinery capacity on the West Coast." (Overcast, Exh. A/T-93 at 38:11-18). Dr. Overcast concludes from Tesoro's market share that, hypothetically, if the intrastate rates did cause any impact on availability of ANS crude to West Coast refiners, the impact would be limited to less than 2%. (*Id.* at

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[34] The Presiding Judge sustained an objection to questions by Carriers on cross examination intended to show that the consumption of refined products (*e.g.*, jet fuel) within Alaska, whether produced locally or imported, was at all relevant to demonstrate impact on interstate markets. (Tr. 6219:20-6220:17.)

38:15-18). And, since the West Coast and Alaskan refineries make up only 18.5% of United States refining capacity, the effect of reduced ANS supply would be less than 0.4% nation-wide. (*Id.* at 38:15-18.) Even if Tesoro's Alaska refinery were able to quadruple its usage of ANS crude capacity and assuming the same increase in finished light product exports, its shipments would still be less 1% of the West Coast market – a negligible effect on competition.

(B) THE CARRIERS FAIL TO SHOW THAT THE RCA'S INTRASTATE RATES HAVE CAUSED INCREASED USE BY ALASKA REFINERIES OF ANS CRUDE.

The bare theoretical allegations by the Carriers' witness Kalt (Exh. ATC-4 at 65-66; Exh. ATC-161 at 38) that Alaska refineries' use of ANS oil has increased as a result of the lower intrastate rates is contradicted by substantial record evidence.[35] As discussed herein, the record shows that the slight increase in Tesoro's consumption of ANS crude is primarily the result of a decrease in the supply from its preferred source of local crude (Cook Inlet) and an increase in demand within Alaska.

Total Alaska crude refining capacity between 2001 and 2006 has varied less than 4% and actually declined slightly between 2004 and 2006, the period during which the RCA finalized TAPS intrastate rates for years 2001, 2002, and 2003. (Exh. FHR-2 at 6-8; Exh. FHR-4.) While it is true that Tesoro's Kenai refinery has experienced an increase in ANS crude usage, that increase was not *caused* by lower intrastate rates. Flint Hills witness Sanderson explains that while the majority of Alaskan refineries

[35] The Carriers' allegation even appears inconsistent with the Carriers' own filed testimony. The Carriers' witness Dr. Kalt noted (Exh. ATC-161 at 40:11-14) that Flint Hills has actually "reduced the quantity of ANS crude oil it refines in Alaska by 10,000 barrels a day...."

depend solely on TAPS to deliver the crude that they process, the Kenai refinery processes both ANS and other (*e.g.*, local) crudes. (Sanderson, Exh. FHR-2 at 5-7.)

The Kenai refinery's preferred source of crude, which comes from Cook Inlet, is a local crude that is not delivered by TAPS. The Kenai refinery uses ANS crude only to the extent it cannot receive delivery of enough Cook Inlet crude to satisfy the demand for its products. (Exh. FHR-2 at 14:3-14.) Cook Inlet crude supplies have been decreasing, which has required the Kenai refinery to use more ANS crude to satisfy the same product demand. (Exh. FHR-2 at 14:11-14; Exh. FHR-9, Tesoro Kenai Refinery Crude Oil Throughput by Type.)

Anadarko/Tesoro witness Dr. Overcast confirms the causal relationship between decreasing Cook Inlet supply and Tesoro's resultant increased reliance on ANS crude. (Overcast, Exh. A/T-159 at 14:17-15:10; Tr. 6221-23.) Dr. Overcast notes that there was a modest increase in intrastate shipments to Kenai in 2006 of 1.6 million barrels and that the "decline in Cook Inlet production explains most of this increase in intrastate deliveries." (Overcast, Exh. A/T-159 at 14:17-15:1.) Dr. Kalt acknowledges Kenai's increased usage of ANS crude but offers no evidence that would rebut the interdependent relationship between Cook Inlet and ANS crude. (Exh. ATC-161 at 38.)

As Cook Inlet supplies continue to decrease and the demand in Alaska for Kenai's refined products continues to increase, the Kenai refinery will have to purchase more ANS crude to meet that demand irrespective of the magnitude of the intrastate price. The Carriers have not disputed this fact and offer no substantial evidence to support their theoretical relationship between intrastate prices and small local increases in ANS crude usage.

(c) THE CARRIERS FAIL TO SHOW THAT THE RCA'S INTRASTATE RATES CAUSED MAJOR WEST COAST REFINERY INVESTMENTS.

The Carriers' claim (Kalt, Exh. ATC-4 at 66:19-67:5) that lower intrastate rates have somehow caused West Coast refiners to invest billions of dollars to upgrade their refineries is completely unfounded. First, accepting the Carriers' dubious claim for argument's sake, upgrading investment is not typically viewed as an economically negative act. Second, the claim is not merely dubious, it is specious. The Carriers' sole support for this contention is an *Oil and Gas Journal* article dated 1997, published more than five years *before* Order 151 was issued. (Kalt, Exh. ATC-4 at 67, n.65.) Mr. Sanderson explains not only that the article preceded the RCA's implementation of lower intrastate rates but that the investment the article discussed was to facilitate processing of "the growing supplies of California crude anticipated at that time and to comply with [ ] California's very stringent formulated gasoline regulations...." (Sanderson, Exh. FHR-2 at 15:3-16.)

Anadarko/Tesoro's witness Dr. Overcast identifies a number of factors that could have led to capital investment in West Coast refineries including "refining of more California crude oil, the political opposition to tankers as a supply source (a further limitation on ANS imports and incentive to refine ANS locally), and to produce the reformulated gasoline required in California." (Overcast, Exh. A/T-93 at 36.) Recognizing that ANS crude supply had been on the decline since 1988, Dr. Overcast finds it reasonable that West Coast refineries would make capital investments to facilitate the refining of oil sourced from locations other than ANS if they hoped to maintain the same product output. (*Id.* at 37.) In fact, Dr. Overcast notes (*Id.* at 37:8-12) that West Coast and Alaskan refineries since 1990 "consistently operate at capacity

factors in excess of 87 percent annually," which confirms that alternative crude supplies (and capital investment to process that crude) were and remain necessary to maintain high capacity factors in light of decreasing ANS supplies. The Carriers have not proved that refinery infrastructure investments on the West Coast were in any way the result of Order 151.

(D) THE CARRIERS AND THEIR PARENT COMPANIES DOMINATE THE INTERSTATE ANS CRUDE MARKET; INDEPENDENT ALASKA REFINERIES HAVE A NEGLIGIBLE EFFECT ON THAT MARKET.

The Carriers' assertion that reductions in ANS deliveries to the West Coast are caused by the lower intrastate rate is unsupported. (Kalt, Exh. ATC-4 at 63). The Carriers' affiliates export 98% of all ANS crude oil that leaves Valdez (Sanderson, Exh. FHR-2 at 11:21-23) from which it can be reasonably concluded that no one else can compete to supply ANS crude to the West Coast.[36] As Dr. Overcast explains, the decline in ANS deliveries began long before Order 151 was issued: "As illustrated in Exhibit A/T-94, the production of Alaska North Slope ('ANS') crude began to decline in 1988 and declined continuously through 2001, except for 1991. After a slight increase in 2002 production, production has continued to fall off through 2005." (Overcast, Exh. A/T-93 at 35).

Order 151 (issued in November 2002) cannot be responsible for a decline in ANS output that began in 1988. Dr. Overcast correctly concluded (Exh. A/T-93 at 35) that no party has offered any analysis to show any causal link between lower intrastate rates

[36] Of the approximately 900,000 barrels per day ("bpd") produced at Pump Station 1, approximately 800,000 bpd are delivered by TAPS to the Valdez terminal. Only 20,000 to 30,000 of those 800,000 bpd is processed by Tesoro's Alaskan refinery; the rest is exported. (Sanderson, Tr. 3098-104.)

and declining ANS output. The Carriers failed to provide any substantial evidence to prove that lower RCA intrastate rates have harmed interstate commerce.

(E) THE CARRIERS FAILED TO DEMONSTRATE ANY INJURY TO INTERSTATE SHIPPERS HAS RESULTED AND WILL CONTINUE TO RESULT BECAUSE OF THE DISPARITY IN RATES.

The Carriers incorrectly allege that interstate shippers will be injured as a result of the RCA's intrastate rates because the Carriers are permitted under the Interstate Settlement Agreement to pass onto interstate shippers whatever costs the RCA disallows. (Kalt, Exh. ATC-4 at 62:16-63:5.) The Carriers argue that the lower RCA intrastate rates result in an annual "$38 million shortfall in intrastate rates" when compared to the TSM intrastate rate that they filed and the RCA rejected. (Kalt, Exh. ATC-4 at 64:3-5; Kalt, Exh. ATC-161 at 44:1-3; *see* Toof calculation, Exh. ATC-12 at 61:11-14.) Dr. Toof calculates a $49 million shortfall for 2006 (Toof, Exh. ATC-164 at 50:13-16). Through the application of the Interstate Settlement Agreement crediting mechanism, the Carriers note that this "shortfall" is being paid "dollar for dollar, by interstate shippers (*unless a TAPS Carrier decides for some reason to take a voluntary revenue reduction*)." (Kalt, Exh. ATC-4 at 64:9-15, emphasis added.)

The Carriers' allegation fails to prove harm to interstate shippers from the lower intrastate rates for two key reasons. First, the alleged harm is directly caused by the Carriers' voluntary application of the Interstate Settlement Agreement crediting mechanism, not the intrastate rates. The costs the Carriers pass through (or shift) to interstate shippers are costs associated with intrastate service that the RCA disallowed in Order 151 as not just and reasonable. The RCA recognized that while the Interstate Settlement Agreement permits this result, it does not mandate it:

> [A]lthough the Carriers may apply revenue "shortfalls" from intrastate to interstate tariffs, nothing in the Interstate Settlement Agreement requires them to do so. If the Carriers take advantage of the Settlement's crediting provision, future interstate tariffs for the same transportation service will rise above the cost-based intrastate rates that we determine in this order to be just and reasonable. *Although the Carriers certainly have an incentive to raise rates, they also have an incentive to treat the State and ... shippers fairly.*

(Order 151 at 30-31.)

Second, the Carriers are the only parties complaining about potential injury to interstate shippers. *No independent interstate shipper filed any testimony in support of the Carriers' position.* Because 98% of the ANS crude that leaves the Valdez terminal in interstate commerce is shipped by Carrier-affiliated shippers (Sanderson, Exh. FHR-2 at 11:21-23), the shippers that are allegedly injured by the Carriers' voluntary decision to shift disallowed intrastate service costs to interstate shippers are the Carriers' own affiliates or, more appropriately, the Carriers' parent companies where the revenues ultimately reside.

State's witness Dr. Rapp effectively counters the Carriers' argument that interstate shippers are subsidizing intrastate shippers. (Exh. SOA-6 at 24-27.) Dr. Rapp correctly notes that no Carrier witness has demonstrated that RCA intrastate rates are below cost and that, absent such a showing, there can be no economic subsidy. (Exh. SOA-6 at 24-25.) As Dr. Rapp notes, Dr. Toof's calculation does not attempt to compare intrastate rates with the actual cost of intrastate service. "All he does is demonstrate that, under his application of the TSM for setting maximum interstate rates, an increase in revenues from intrastate service leads to lower maximum rates for interstate service." (Exh. SOA-6 at 26:9-12.) Even if reduced RCA rates automatically

resulted in increased interstate rates – which is not the case – there is no subsidy because there is no evidence that the cost of intrastate service is not fully recovered in intrastate rates, as discussed above.

The alleged injury to interstate shippers flows from the Carriers' decision to use the Interstate Settlement Agreement to recover from interstate shippers putative revenue shortfalls due to Order 151. Whether the Carriers decide to continue to recover these unjust and unreasonable revenues from interstate shippers (primarily their own affiliates) is their choice (until FERC decides that their ability to do so is unjust and unreasonable). However, the Carriers' exercise of this choice is not an injury caused by Order 151 rates.

4. THE CARRIERS FAILED TO PROVE THAT A SUBSTANTIAL INCREASE IN THEIR REVENUE WILL RESULT FROM THE PROPOSED INCREASE IN THE INTRASTATE RATES.

Since the Carriers have not submitted cost-of-service evidence, they have not proved that the currently effective intrastate rates fail to fully recover the cost of intrastate service. If we assume *arguendo* that the intrastate rates do not fully recover costs, the Carriers fail to show the amount of the increase that would be needed to increase the intrastate rates to a cost-justified level. Therefore, there is no practicable way to determine whether such an increase would satisfy the Supreme Court's test of substantiality.

We emphasize that we are merely assuming for argument's sake that the intrastate rates do not fully recover costs, when in fact those rates do fully recover costs as the RCA found in Order 151. We also emphasize that if (hypothetically) intrastate rates did not fully recover costs and if other evidentiary requirements were satisfied, any

Section 13(4) increase would not be to the TSM rate level but to the cost-justified level. The reason is that Supreme Court precedent, as discussed above, would not allow the FERC to increase the intrastate rates to recover more than actual intrastate costs. The fact that there might be a disparity between the intrastate rates and the interstate TSM rates is irrelevant. Reliance on the disparity in rates in and of itself is insufficient to sustain a Section 13(4) claim. *Mississippi,* 124 F. Supp. at 816. If the disparity is not cost-based both at the intrastate and interstate levels and if there is not additional evidence addressing other elements of a Section 13(4) claim, there is no FERC authority to supersede a state ratemaking decision and modify a state-set rate.

There is an additional possibility. FERC may elect to depart from the TSM rates and establish a just and reasonable interstate rate that eliminates unjustified non-cost components like APB, employs accelerated TSM depreciation for the period pre-2005, incorporates the correct useful life for post-2005 straight-line depreciation, and makes other appropriate corrections to the Carriers' Opinion 154-B analysis. In that event, any difference between the RCA-approved intrastate rates and FERC-approved interstate rates will be considerably smaller and could be non-existent, and the issue of the alleged need for substantially increased revenues will become moot.[37]

5. THE CARRIERS FAILED TO DEMONSTRATE THAT THEIR PROPOSED INTRASTATE RATES ARE JUST AND REASONABLE.

The cases in which the Supreme Court affirmed an ICC order under Section 13(4) were all cases in which the ICC, pursuant to Section 15a, had established overall

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[37] *See* Section V.D.1(A) above.

just and reasonable revenue requirements for railroad carriers.[38] The ICC then determined that abnormally low intrastate rates prevented the railroad carriers from achieving minimum total just and reasonable revenue requirements. Here there is no foundation for the fifth key element of the Carriers' Section 13(4) case because the TSM revenue requirements that the Carriers seek to impose on intrastate shippers have never been determined by FERC to be just and reasonable.

The Carriers failed in the RCA proceeding to demonstrate that TSM resulted in just and reasonable rates, principally because TSM is not a standard original cost-based methodology and provides an opportunity for significant over-recovery of their investment. (Order 151 at 8.) The RCA, relying on a traditional DOC analysis, developed a just and reasonable rate that provided for a fair share of the Carriers' costs. In the unlikely event FERC decides that the Carriers' TSM rates are just and reasonable for interstate purposes, the Presiding Judge would have to conclude with a high standard of certainty based on substantial evidence that every other Section 13(4) condition was satisfied and, in particular, that the intrastate rates were not contributing their fair share of total revenue requirements, before FERC could supplant the RCA intrastate rate.

As discussed below, there is no requirement in the ICA that either rates or ratemaking methodologies be identical at the federal and state levels.[39] The intrastate rates are designed to be and in fact are entirely compensatory for the Carriers. There

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38 In any event, establishing revenue requirements pursuant to Section 15a – as was done in the Section 13(4) cases – makes no sense because TAPS is not a railroad. *See* Section V.A above.

39 *See* discussion *infra* Section V.D.6(D).

may be reasonable differences between the rates adopted by the RCA and by FERC. Such reasonable differences are well within the federalism contemplated by the ICA and the U.S. Constitution and may account for differences in the resulting rates but would not provide a rationale for nullifying intrastate rates pursuant to Section 13(4).

6. ADDITIONAL FACTORS SUPPORT REJECTION OF THE CARRIERS' SECTION 13(4) PETITION.

The court in *Mississippi*, in applying the Supreme Court's decision in *North Carolina*, recognized that the federal agency must take into consideration conditions and circumstances in addition to the five key elements identified by the court, in deciding whether the agency may supplant the intrastate rate. 124 F. Supp. at 814-15.[40] The relevant additional factors in this case strongly support rejection of the Carriers' Petition.

(A) PUBLIC POLICY CONSIDERATIONS

The ICA provides FERC broad authority to establish interstate rates, as it will do in this proceeding. As discussed above, Section 13(4) of the ICA does not authorize FERC to prescribe intrastate oil pipeline rates. However, if the Presiding Judge concludes that FERC does have such jurisdiction, FERC's authority to nullify intrastate rates is very narrowly constrained. FERC's nullification of an intrastate rate, established after full due process pursuant to state law, raises serious policy concerns.

Consistent with Constitutional principles of federalism, the ICA assigns the primary authority for establishing intrastate rates to the states. Here, the RCA spent

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[40] *See also Utah*, 356 U.S. at 425, noting that the five key findings were "*inter alia*" adequate to support a Section 13(4) order; in *King*, 344 U.S. at 266, the court held that Section 13(4) must be construed "in light of § 15a(2) and as supplementing it"; *Florida II*, 292 U.S. at 7 n.3, discussing House Report regarding the need for the ICC to consider various factors "in the public interest."

several years establishing the intrastate rates at issue, as reflected by the 75,000 pages of the record in those proceedings. The intrastate rates were established by Order 151, which was affirmed by the Superior Court of Alaska and is now on appeal to the Alaska Supreme Court.

The possible preemption of these rates by this Commission is a matter of serious concern to the RCA and no doubt to other state commissions. For this reason, the Chairman of the RCA and two RCA Commissioners were present at the commencement of this proceeding, and the RCA has monitored this proceeding closely. If this Commission does exercise its authority under Section 13(4), all of the legal proceedings in Alaska will be essentially overruled, and the time and energy spent on those proceedings will have been wasted.

A decision to preempt the Alaska intrastate rates would also have the deleterious effect of rewarding the Carriers' transparent foru .-shopping tactics: having failed to win the high intrastate rates they sought at the RCA for the pre-2001 period, the Carriers then turned to this Commission to set both interstate rates and, as a matter of first impression and without any involvement by the RCA, intrastate rates. Of course, the Presiding Judge need not even reach the Carriers' forum-shopping strategy since (1) Section 13(4) does not provide FERC with authority to prescribe intrastate oil pipeline rates; and (2) the Carriers' failure to satisfy Section 13(4)'s stringent burden of proof requirements, in and of itself, is dispositive against and requires rejection of their Petition.

Any decision by the FERC to nullify the RCA's rates will have serious repercussions beyond Alaska to the rest of the country. States will be decidedly less

secure in establishing intrastate rates for oil pipelines, and oil pipelines will be emboldened to seek further nullification of such rates under Section 13(4), essentially vetoing less-than-favorable state commission decisions.

Because of the basic principles of federalism at stake, the Supreme Court has recognized these policy considerations in establishing the stringent burden of proof on Section 13(4) petitioners. The Court recognizes that "intrastate transportation is primarily the concern of the State," *Utah*, 356 U.S. at 425-26; that Section 13(4) authority is "exceptional," *Chicago, Milwaukee*, 355 U.S. at 306; and that the justification for the exercise of this exceptional power "must clearly appear," *Florida I*, 282 U.S. at 211-212. Also (and as discussed below), Congress attempted to avoid these negative effects through Section 13(3), which contemplates coordination and consultation and even joint hearings as a means of preserving and respecting the state regulatory process. Consistent with controlling precedent, the Presiding Judge should take into account these public policy factors that weigh heavily against granting the Section 13(4) Petition.

The fact is that neither the ICC nor FERC has ever issued an order raising intrastate oil pipeline rates. As the Argument demonstrates, this is emphatically not the case that should break with precedent.

(B) THE CARRIERS' FAILURE TO MAKE FILINGS TO RAISE INTRASTATE RATES SHOULD PRECLUDE THEM FROM ARGUING BEFORE FERC THAT INTRASTATE RATES ARE ABNORMALLY LOW AND NON-COMPENSATORY.

The Presiding Judge should determine that the regulatory history of Order 151 and the Carriers' own conduct precludes them from claiming at FERC that intrastate rates are abnormally low and non-compensatory. As discussed in this subsection, the

Presiding Judge can rely on one or more well-settled principles of deference, waiver, and judicial comity to find that Carriers are barred from relitigating the reasonableness of the intrastate rates. If she finds that the Carriers are thus precluded, their Section 13(4) challenge necessarily fails.

Intrastate rates that are the result of extensive and comprehensive state commission proceedings deserve reasonable deference by the federal agency. *Mississippi*, 124 F. Supp. at 814. In setting aside the underlying ICC order, the District Court in *Mississippi* recognized that the duty to fix intrastate rates is primarily the state's duty and in that case emphasized that the state commission "gave great study and investigation and heard much testimony before the [state] Commission itself and not through an examiner." *Id.* The court also noted: "The findings of a state commission which is familiar with such conditions in the state, ... when its opinion differs from the Interstate Commerce Commission's findings detracts heavily against the findings of the Interstate Commerce Commission...." *Mississippi*, 124 F. Supp. at 815.

The identical regulatory circumstances pertain here. As in *Mississippi*, Order 151 is the result of extensive state administrative proceedings. (*See, e.g.*, Order 151 at Endnote 2; Exh. A/T-138.) The Order 151 proceeding before the RCA required a period of six years at a cost of approximately $20 million. (Brown, Exh. A/T-78 at 69:18-70:3.) The record supporting Order 151 spans 75,000 pages, including numerous depositions and exhibits. (*Id.*)

In its 168-page order (excluding endnotes and exhibits), the RCA found the TSM-set rates to be unjust and unreasonable and determined rates, based on a traditional DOC analysis, that are just and reasonable. (Brown, Exh. A/T-78 at 70:10-15.) The

RCA's guiding regulatory principle in the Order 151 proceeding was that the Carriers should be permitted to recover their actual costs of operations, the return of their capital, and a reasonable return on their investment. (*See, e.g.*, Order 151 at 12.) Order 151 was affirmed by the Alaska Superior Court in all respects. (January 18, 2006 "Decision and Order" in Case No. 3AN-02-13511 CI; Brown, Exh. A/T-78 at 73:21-24.) The Carriers appealed the Superior Court decision to the Alaska Supreme Court; oral arguments are scheduled for March 2007. As in *Mississippi*, FERC should recognize and afford reasonable deference to the extensive investigation and proceedings that led to the RCA's issuance of Order 151.

In Order 151, the RCA offered the Carriers the opportunity to file cost-based rates consistent with the principles set forth in Order 151 to the extent the Carriers sought higher intrastate rates after 2000. (Order 151 at 162.) The Carriers have continuously refused to file cost-based intrastate rates as required by Order 151 and instead have filed TSM rates at the RCA for the years 2001-2007.[41] Because the Carriers have refused an ongoing opportunity to make filings to raise intrastate rates, the Carriers have continued to collect the rates established in Order 151. The RCA orders rejecting the Carriers' TSM filings for 2001 through 2006 are part of the evidentiary record in the instant FERC proceeding.[42]

For purposes of this Section 13(4) proceeding, the Carriers' continuing failure to file *at the RCA* for increased intrastate rates constitutes a waiver of their right to now

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[41] *See, e.g.*, RCA Orders in Docket Nos. P-03-4(34); P-04-4(1); P-05-1(1); P-06-1(1); P-07-1(1) (orders rejecting TSM rates).

[42] *See* Appendix B for a list of relevant RCA orders.

complain *at FERC* that intrastate rates are abnormally low and non-compensatory. Waiver is the "intentional relinquishment or abandonment of a known right." *Kontrick v. Ryan,* 540 U.S. 443, 458 n.13 (2004). If the Carriers were able to show that cost-based intrastate rates should be higher than Order 151 rates, they would have filed such rates at the RCA, but they have chosen not to do so. The Carriers have clearly waived their right to apply for higher intrastate rates at the RCA.

The Presiding Judge should also consider whether the ratemaking decisions reached by the RCA on the merits and affirmed by the Alaska Superior Court are in the interest of equity and fairness entitled to a degree of judicial comity. Judicial comity is "[t]he respect a court of one state or jurisdiction shows to another state or jurisdiction in giving effect to the other's laws and judicial decisions." BLACK'S LAW DICTIONARY 262 (7th ed., 1999).[43] Order 151 found that the intrastate rate is not abnormally low and does adequately compensate the Carriers for all components of their cost of service.

Based on one or more of the well-established principles discussed above, the Presiding Judge should determine that the extensive proceedings before the RCA and/or the Carriers' waiver of their rights to file new tariffs compliant with Order 151 prohibit the Carriers from challenging the Order 151 rates before FERC as abnormally low and non-compensatory.

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[43] The Commission has concluded that it is not proper to reconsider an issue previously decided by a civil court. *United Gas Pipe Line Co.*, 20 FERC ¶ 63,070 at 65,293-94 (1982), *aff'd*, 31 FERC ¶ 61,336 (1985), *aff'd in pertinent part*, 824 F.2d 417 (5th Cir. 1987).

(c) THE CARRIERS' TRANSPARENT END-RUN AROUND ALASKA REGULATORY PROCESS SHOULD NOT BE PERMITTED.

Rather than comply with Alaska law, the Carriers attempt an end-run around the regulatory and judicial process in Alaska by petitioning FERC to set aside the intrastate rates. (Brown, Exh. A/T-78 at 74:13-75:12.) Their Section 13(4) Petition is nothing more than transparent forum-shopping. The Carriers have not, since Order 151 was issued, filed at the RCA in compliance with Alaska law to establish a test year for future rates, which undermines their complaint that the intrastate rates are not compensatory. In Order 151 the RCA "[concluded after] careful review of the record ... that the 1997-2000 filed intrastate TAPS rates do not satisfy the AS 42.06 requirement that pipeline rates be just and reasonable, set new 1997-2000 rates *and order[ed] filings so that we can set rates for 2001 and subsequent years*." (Order 151 at 1-2, emphasis added.)

In Ordering Paragraph 13 (Order 151 at 167) the RCA clarified that the information the Carriers were required to file (by January 13, 2003) was the information necessary to calculate a revenue requirement and rate base for 2001 and future years using the DOC methodology. Instead of complying with that filing requirement, the Carriers continued to limit their filings at the RCA to the higher TSM-based intrastate rates. (Brown, Exh. A/T-78 at 74:18-75:22.) On December 16, 2005, the RCA rejected the Carriers' TSM intrastate filings for 2006 "because the filings do not contain the supporting information required by our regulations." (Exh. A/T-136.) A similar order was issued on December 28, 2006 rejecting Carriers' TSM intrastate filings for 2007. (*See* P-07-1(1), *Order Rejecting 2007 Intrastate TAPS Settlement Methodology Rates.*)

The Carriers appealed Order 151 to the Alaska Superior Court and lost. The Court upheld the RCA's order in all respects. The Superior Court reached the following conclusions on issues now raised in this proceeding before FERC:

(1) "that RCA has a reasonable basis to conclude that the rates from 1977 through 1982, filed by the Carriers but never approved on their merits by the Alaska Public Utilities Commission, *were sufficiently robust to be deemed inclusive of accelerated depreciation*," *Amerada Hess v. RCA*, 3AN-02-13511C1 at 32 (Jan. 2006) (emphasis added);

(2) "that the initial rate base and *the 1983-1985 rates were retroactively established under TSM* in accord with the accelerated precept," *id.* (emphasis added);

(3) "that the *1982 depreciation stipulation was superseded by the TAPS settlement and had no effect* on the initial rate base and subsequent rates," *id.* (emphasis added);

(4) "that *accelerated depreciation* was embedded in all post-settlement rates, and *was properly used to derive the year-end 1996 rate base* [which was the test year for the 1997 intrastate rate]," *id.* (emphasis added);

(5) "that *artificial reversion to a deemed straight-line depreciation ab initio would unreasonably subject the shippers to the burden of twice compensating the Carriers* for a portion of their investment and contravene RCA's mandate to set just and reasonable rates," *id.* at 32-33 (emphasis added);

(6) that the settlement does not preclude non-parties or the RCA from looking at the "TAPS settlement to measure accumulated depreciation for purposes of rate base calculation," *id.* at 34; and

(7) that the "RCA twice afforded the carriers an opportunity to file rates supported by actual cost data [but] [t]he Carriers persisted in their more theoretical rate defense," *id.* at 47.

Having lost at the RCA and on appeal at the Alaska Superior Court, the Carriers attempt a hedging strategy both by appealing the Superior Court decision to the Alaska Supreme Court to set aside Order 151 and, in parallel, petitioning FERC under Section

13(4) to supplant the RCA-set intrastate rate. Oral arguments before the Alaska Supreme Court are scheduled for March 2007, two months before the Presiding Judge's Initial Decision is due in this proceeding.

The Presiding Judge should not reward the Carriers' forum-shopping. Instead, she should allow due process to take its full course in Alaska by permitting the Alaska Supreme Court to have the last word on Order 151.

(D) IN THE ABSENCE OF UNDUE DISCRIMINATION, SOME DIFFERENCE BETWEEN INTRASTATE AND INTERSTATE RATES IS REASONABLE.

Once FERC sets a just and reasonable interstate rate that complies with Opinion 154-B based on appropriate cost inputs, the RCA anticipates that the magnitude of difference between interstate and intrastate rates will decrease markedly but may not disappear entirely. It is significant that the ICA does not require state and federal rates to be identical:

> It is suggested that the [ICC], in granting general interstate increases, frequently proceeds on the assumption that intrastate rates will be raised to the same level. But this assumption is no through ticket permitting it to approach the question of intrastate rates with partiality for a uniform increase. *Rate uniformity is not necessarily the goal of federal regulation, nor can the [ICC]'s wishful thinking be substituted for substantial evidence*. Section 13 is not cast in terms of "assumption" or "partiality." As applied to this case, it contemplates an inquiry into intrastate rates and conditions within [the state]....

Utah, 356 U.S. at 428 (emphasis added). This is a point upon which both the RCA and the Carriers agree. (Kalt, Exh. ATC-161 at 43:15-17.)

State witness Dr. Rapp agreed that there is more than one way to determine a just and reasonable rate and that a difference in rates resulting from the RCA's use of DOC and FERC's use of 154-B TOC does not imply that the RCA rate is non-

compensatory. (Tr. 3956 – 3961.) Differences in the capital structure, return on equity, debt cost, and depreciation method used by FERC and the RCA could all reasonably explain rate differences without implying that the state rate is non-compensatory. (*Id.*) Furthermore, to the extent rate differences merely represent timing differences in the revenue recovery over the life of the TAPS asset, the rate disparity may be nominal rather than actual for Section 13(4) purposes and thus not a proper basis for a Section 13(4) claim.

In Order 151 (at 150) the RCA found that

> the appropriate life of TAPS for ratemaking purposes extends through the year 2026, fifteen years beyond the current assumed 2011 end of TAPS life. Accordingly, for ratemaking purposes we find that the remaining economic life of TAPS as of January 1, 1997 extends for 30 years to December 31, 2026.

Because the RCA found that TAPS has a longer operational life than the period stipulated in the Intrastate Settlement Agreement, intrastate depreciation charges are lower on a yearly basis than TSM depreciation rates.

Also, the intrastate rates established by the RCA do not include charges for DR&R:

> Because many years remain in the life of TAPS during which we can adjust the amounts to be collected for DR&R, because DR&R issues are complex and costly, and because we do not have a sufficient record to rule on appropriate DR&R charges for 1997-2000, we do not award DR&R in this order.

(Order 151 at 157-58.) The Carriers were provided an opportunity to prove that DR&R charges should be recovered in current rates, but they waived their right to do so.[44] The Carriers neither address this key difference between intrastate rates and TSM rates, nor do the Carriers show why they are entitled to recover DR&R charges in intrastate rates on the basis of a cost-based ratemaking methodology. (Sullivan, Exh. A/T-79, at 24-27.)

(E) COLLATERAL ESTOPPEL APPLIES TO THE CARRIERS' CLAIM THAT INTRASTATE RATES ARE NON-COMPENSATORY.

Under collateral estoppel, "once a court has decided an issue of fact or law necessary to its judgment, that decision may preclude relitigation of the issue in a suit on a different cause of action involving a party to the first case." *Allen v. McCurry*, 449 U.S. 90, 94 (1980). The United States Supreme Court concluded that "[w]hen an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply *res judicata* to enforce repose." *Univ. of Tennessee v. Elliott*, 478 U.S. 788, 797-98 (1986), *quoting United States v. Utah Constr. & Mining Co.*, 384 U.S. 394 at 421-22 (1966). The Court found that "giving preclusive effect to administrative fact-finding serves the value underlying general principles of collateral estoppel: enforcing repose." *Univ. of Tennessee*, 478 U.S. at 798.

FERC routinely recognizes the applicability of the doctrine of collateral estoppel to its administrative judicial proceedings where changed circumstances do not justify

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[44] *See Amerada Hess Pipeline Corp.*, P-03-4 (Order No. 34) at 75-76, n.190 (2004). Citing *Statement and Proposed Guarantees of the TAPS Carriers*, filed June 15, 2003, the RCA notes that "Carriers have waived any right to seek additional DR&R funds in intrastate rates for 2001, 2002 and 2003."

relitigation. In *Nantahala Power & Light Co.*, 29 FERC ¶ 61,179 at 61,374 (1984), FERC noted that "the doctrines of *res judicata* and collateral estoppel are applicable to administrative proceedings." (*Id.*, *citing Utah Constr. & Mining Co.*, 384 U.S. at 442.) FERC concluded that collateral estoppel (or issue preclusion) may be invoked "with its usual purpose of preventing relitigation of issues earlier aired by the parties and determined by an adjudicatory tribunal." (*Id.* at 61,374, n.4, *citing Second Tax. Dist. of Norwalk v. FERC*, 683 F.2d 477, 484 (D.C. Cir. 1982).)

FERC has explained that collateral estoppel applies as a matter of policy "only where the issues were fully litigated and decided on the merits, and no new evidence or new circumstances would justify relitigation." *Iroquois Gas Transmission Sys., L.P.*, 87 FERC ¶ 61,268 at 62,092 (1999), *citing, e.g., San Diego Gas & Elec. Co. v. Pub. Serv. Co. of New Mexico*, 86 FERC ¶ 61,253 (1999); *see also Nevada Power Co.*, 27 FERC ¶ 61,487 at 61,940 (1984) (granting motion for summary judgment because company "suggested no changed circumstances to justify a departure from the consistent precedent"); *Cent. Kansas Power Co., Inc.*, 5 FERC ¶ 61,291 at 61,621 (1978) ("It is contrary to sound administrative practice and a waste of resources to relitigate issues in succeeding cases once those issues have been fully determined."); *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286, 1294 (D.C. Cir. 2000) (reversing and remanding FERC's application of collateral estoppel for failing "to respond meaningfully to the [new] evidence").

The essential elements of collateral estoppel are present here, in particular with respect to whether the intrastate rates set by the RCA are just and reasonable, and therefore by necessity not abnormally low and non-compensatory. The Alaska Superior

Court affirmed in all respects the RCA's decision in Order 151 that rejected TSM-based rates and set just and reasonable rates. To reach this decision, the RCA had to determine that those rates provide sufficient compensation consistent with the United States Supreme Court decision in *Hope*,[45] the D.C. Circuit decision in *Farmers Union*,[46] Alaska Stat. § 42.06.370 and Alaska state commission decisions,[47] all of which require that intrastate rates be just and reasonable. The Carriers in the RCA proceeding that lost on the issue of whether the intrastate rates are sufficiently compensatory are the same parties before FERC in this proceeding. To make their Section 13(4) case, Carriers must prove the converse of what has been decided by the RCA and affirmed by the Superior Court, *i.e.*, they must prove that the intrastate rates are not sufficiently compensatory.

Nor have the Carriers offered any evidence of changed circumstances that would justify relitigation of the just and reasonableness of the intrastate rates set in Order 151. Order 151 established intrastate rates that were originally limited to years 1997 through 2000. Rather than comply with Order 151 and state statutes, the Carriers have chosen year after year not to justify higher rates under cost-based ratemaking principles as required in Order 151 and Alaska statutes.[48] As a consequence, the Order 151 rates continue to apply and Carriers have not offered any changed circumstances, either at the RCA or in this proceeding, which would warrant relitigation.

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[45] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[46] *Farmers Union*, 734 F.2d at 1502.

[47] *See, e.g., Re Kenai Pipeline Co.*, 12 APUC 425, 433, 1992 WL 696192 (Alaska P.U.C. 1992).

[48] *See* Appendix B listing RCA Orders rejecting Carrier intrastate rate filings.

Principles of collateral estoppel or issue preclusion encompass decisions by state courts or state regulatory agencies that satisfy the traditional criteria discussed above. In *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 466 n.6 (1982), the Court noted that "the federal courts consistently have applied res judicata and collateral estoppel to causes of action and issues decided by state courts." The court in *Dias v. Elique*, 436 F.3d 1125, 1128 ([illegible] Cir. 2006), held that "[f]ederal courts give the same preclusive effect to the decisions of state administrative agencies as the state itself would...." There is no factual, legal or policy reason why FERC should not give preclusive effect to the RCA's findings, as affirmed by the Superior Court, that intrastate rates are fully compensatory.

The Presiding Judge should apply the doctrine of collateral estoppel to prevent the same parties (the Carriers) from relitigating the same issue (that the intrastate rates are sufficiently compensatory) that has been conclusively decided by the RCA and affirmed by the Alaska Superior Court. If the Presiding Judge does not determine that the Carriers' right to challenge the intrastate rates as non-compensatory before FERC is barred, consistent with *Mississippi*, she should nevertheless give substantial weight to the RCA's extensive proceedings and the fact that the Carriers have refused for six years to file cost-based rates in Alaska. Under the first required element of the Section 13(4) *prima facie* case, the Carriers' refusal to file cost-based rates in Alaska constitutes substantial evidence that intrastate rates are fully compensatory if cost-based ratemaking principles are applied.[49]

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[49] *Mississippi*, 124 F. Supp. at 814; *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474 (1951).

(F) SECTION 13(3) OF THE ICA AUTHORIZES FERC TO HOLD JOINT HEARINGS WITH THE RCA.

Section 13(3) of the ICA[50] provides that the state affected by the Section 13(4) Petition shall be "notified of the proceeding" and further provides:

> The Commission may confer with the authorities of any State having regulatory jurisdiction over the class of persons and corporations subject to this chapter or chapter 12 of this title with respect to the relationship between rate structures and practices of carriers subject to the jurisdiction of such State bodies and of the Commission; and to that end is authorized and empowered, under rules to be prescribed by it, and which may be modified from time to time, to hold joint hearings with any such State regulating bodies on any matters wherein the Commission is empowered to act and where the rate-making authority of a State is or may be affected by the action taken by the Commission.

In Section 13(3) Congress recognized the extraordinary effect of nullifying state regulatory orders; expressed respect for principles of federalism; and provided authorization for cooperative regulation between the federal commission and the affected state regulatory commission.

Although the Carriers' Petition refers to Section 13(3) in passing, it specifically requested that the Commission consolidate their Petition with the ongoing proceedings in Docket Nos. IS05-82-000 *et al.* The Carriers' motion for consolidation was an integral part of their "end-run" strategy discussed above to evade the regulatory processes in Alaska. In its August 5, 2005 Notice of Intervention in Docket No. OR05-10-000, the RCA stated at page 2:

> The Regulatory Commission of Alaska files this notice of intervention under 18 C.F.R. § 385.214(a)(2), to participate as a party to preserve its ability to inform the Federal Energy

[50] Interstate Commerce Act, 49 U.S.C. § 13(3) (1976), reprinted in 49 U.S.C. app. § 13(3) (1988). Section 13(3) is set forth in full in Appendix A.

> Regulatory Commission of its position on the petition and related motion in the event the Federal Energy Regulatory Commission does not exercise its discretion under Section 13(3) of the Interstate Commerce Act, 49 U.S.C. App. § 13(3) (1995), to confer and hold a joint hearing with the Regulatory Commission of Alaska on this matter.

Although Congress stopped short of mandating joint regulatory proceedings in Section 13(3), that statute expresses a strong endorsement of such joint proceedings, and the RCA expressed its own receptivity to such joint hearings in its Notice of Intervention. In view of the Congressional intent in Section 13(3), the Presiding Judge should give substantial weight to the fact that the Carriers sought to avoid joint state and federal hearings in their motion to consolidate their Petition with other FERC proceedings and to the fact that a FERC order issued in the absence of such joint hearings may be deficient in the circumstances of this case because the Section 13(4) proceeding did not (at the request of the Carriers) avail itself of the significant state regulatory participation that Congress authorized.

E. CONCLUSION

The Carriers brought the RCA into this consolidated FERC proceeding by filing their July 20, 2005 Section 13(4) Petition to nullify the intrastate rates the RCA meticulously established after a complex and extensive administrative proceeding. A careful examination of the history, the statutory language, and the Supreme Court cases construing Section 13(4) shows that Congress restricted the scope of Section 13(4) to railroads. However, if the Presiding Judge does find that FERC has jurisdiction, the Carriers have entirely failed to meet their exacting burden of proof under Section 13(4), and the Presiding Judge should therefore reject the Petition as unsupported on this record.

In Section V of this Initial Brief, the RCA shows why the Presiding Judge should reject the Carriers' Section 13(4) Petition. As threshold matters, the Presiding Judge may find (1) that the Carriers' Section 13(4) case lacks foundation if she rejects TSM rates and establishes cost-based rates without a material difference from the cost-based rates established by Order 151; and (2) that the Carriers should be precluded from arguing that intrastate rates are abnormally low because they failed to present cost-based evidence showing that intrastate rates do not permit them to recover their actual cost of service.

On the merits of the Section 13(4) case, the Carriers failed to prove a single one of the five critical elements of that case, let alone all five elements. The most significant failures of proof were (1) the failure to show that intrastate rates are abnormally low and non-compensatory; (2) the failure to show any substantial harm to interstate commerce or interstate shippers; and (3) the failure to show that TSM rates are just and reasonable.

The Presiding Judge should consider additional non-economic factors that support rejecting the Section 13(4) Petition. First, public policy considerations, considered in light of the relevant Supreme Court opinions, strongly support permitting Order 151 rates to remain in place until changed under Alaska law. Second, the Carriers should be barred from challenging intrastate rates as too low because they have refused for years to file cost-based tariffs that would allow them to charge higher intrastate rates. Third, the Presiding Judge should not reward the Carriers' transparent forum-shopping strategy; instead due process demands that the Alaska Supreme Court have the final word on intrastate rates. Fourth, the ICA does not require intrastate rates

and interstate rates to be uniform, and the RCA and the FERC have discretion within their respective jurisdiction to apply different ratemaking approaches. Fifth, the Carriers' claim that intrastate rates are non-compensatory is subject to the well-established doctrine of issue preclusion. Sixth, in light of Section 13(3), any Section 13(4) order issued in the absence of joint federal and state regulatory proceedings may be deficient.

For these reasons, the Presiding Judge should reject the Section 13(4) Petition in this proceeding.

Respectfully submitted,

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APPENDIX A

Relevant Statutes

Section 13(3) of the ICA

(3) Investigation involving State regulations; conference of State and interstate commissions

Whenever in any investigation under the provisions of this chapter, or in any investigation instituted upon petition of the carrier concerned, which petition is authorized to be filed, there shall be brought in issue any rate, fare, charge, classification, regulation, or practice, made or imposed by authority of any State, the Commission, before proceeding to hear and dispose of such issue, shall cause the State or States interested to be notified of the proceeding. The Commission may confer with the authorities of any State having regulatory jurisdiction over the class of persons and corporations subject to this chapter or chapter 12 of this title with respect to the relationship between rate structures and practices of carriers subject to the jurisdiction of such State bodies and of the Commission; and to that end is authorized and empowered, under rules to be prescribed by it, and which may be modified from time to time, to hold joint hearings with any such State regulating bodies on any matters wherein the Commission is empowered to act and where the rate-making authority of a State is or may be affected by the action taken by the Commission. The Commission is also authorized to avail itself of the cooperation, services, records, and facilities of such State authorities in the enforcement of any provision of this chapter or chapter 12 of this Appendix.

Section 13(4) of the ICA

(4) Duty of Commission where State regulations result in discrimination

Whenever in any such investigation the Commission, after full hearing, finds that any such rate, fare, charge, classification, regulation, or practice causes any undue or unreasonable advantage, preference, or prejudice as between persons or localities in intrastate commerce on the one hand and interstate or foreign commerce on the other hand, or any undue, unreasonable, or unjust discrimination against, or undue burden on, interstate or foreign commerce (which the Commission may find without a separation of interstate and intrastate property, revenues, and expenses, and without considering in totality the operations or results thereof of any

carrier, or group or groups of carriers wholly within any State), which is hereby forbidden and declared to be unlawful, it shall prescribe the rate, fare, or charge, or the maximum or minimum, or maximum and minimum thereafter to be charged, and the classification, regulation, or practice thereafter to be observed, in such manner as, in its judgment, will remove such advantage, preference, prejudice, discrimination, or burden. Such rates, fares, charges, classifications, regulations, and practices shall be observed while in effect by the carriers parties to such proceeding affected thereby, the law of any State or the decision or order of any State authority to the contrary notwithstanding.

SECTION 15a(2) OF THE ICA AS ENACTED IN 1920

In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures, and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: *Provided,* that the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different sections of the country.

SECTION 15a(2) OF THE ICA AS AMENDED IN 1933

In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed ; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service.

APPENDIX B

<u>CHRONOLOGY OF DOCKET NOS. P-97-4 & -7 AND SUBSEQUENT DOCKETS</u>

11/27/02 RCA issues Order 151 rejecting Carriers' 1997 through 2000 TSM-based intrastate rates and setting just and reasonable rates for years 1997 through 2000. Order P-97-4(151)/P-97-7(110), *Order Rejecting 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings; and Outlining Phase II Issues*, dated November 27, 2002 (Exhibit A/T-31)

12/26/02 RCA issues order suspending and setting for investigation Carriers' 2003 TSM-based intrastate rates, establishing temporary rates and directing Carriers to file rates based on a depreciable cost-of-service analysis as required by Order 151. This order also consolidates in a single docket the suspension and review of Carriers' previously filed TSM-rates for years 2001 and 2002. Order P-94-1-1(118)/P-97-4(152)/P-97-7(111)/P-03-4(1). *Order Suspending TAPS Intrastate Tariff Rates Filed to be Effective January 1, 2003; Opening Docket P-03-4 to Investigate Rates; Designating Public Advocacy Section as a Party; Appointing Administrative Law Judge; Establishing Temporary and Refundable Rates Equal to Filed Rates; Allowing Rates of Phillips Transportation Alaska, Inc., to go into Effect on a Temporary and Refundable Basis with Less Than Thirty Days Notice; Approving Tariff Sheets; Transferring Consideration of TAPS Rates for the Period January 1, 2001 Through December 31, 2002 to Docket P-03-4; and Changing Docket Titles*, dated December 26, 2002.

2/11/03 RCA issues order directing parties to file briefs that would address whether the RCA should set new temporary intrastate rates equal to the intrastate rates set in Order 151 for year 2000. Order P-03-4(5). *Order Affirming Electronic Notification Requiring Briefing on New Temporary Rates, Rescheduling Prehearing Conference and Establishing Hearing*, dated February 11, 2003.

4/18/03 RCA issues order establishing temporary intrastate rates for 2003 equal to the rates set in Order 151 for year 2000 and affirming opportunity for Carriers to participate in a hearing to determine if the new temporary rates cover current operating and maintenance expenses and debt obligations. Order P-03-4(10). *Order Proposing Revised Temporary 2003 TAPS Intrastate Rates, Affirming Opportunity for Hearing and Scheduling Briefing*, dated April 18, 2003.

12/19/03 RCA issues order rejecting Carriers' 2004 TSM-set rates because Carriers failed to supply cost-of-service support required in Order 151. Order P-04-4(1). *Order Rejecting 2004 Intrastate TAPS Settlement Methodology Rates*, dated December 19, 2003. (Exh. A/T-134)

6/10/04 RCA issues order rejecting Carriers' 2001 through 2003 TSM-set rates as non-conforming and unsupported, and setting permanent intrastate rates for years 2001 through 2003 equal to the Order 151 rates for year 2000. Order P-03-4(34). *Order Rejecting the TAPS Carriers' 2001-2003 TSM Intrastate Filings, Rejecting the TAPS Carriers' Post-2000 Revenue Requirement and Rate Filings, Establishing Permanent Post-2000 Intrastate TAPS Rates, Requiring Refunds, Ordering Release of Escrowed Funds, Letters of Credit, and Bonds; Approving Filings and Affirming Electronic Rulings*, dated June 10, 2004. (Exh. A/T-50)

12/30/04 RCA issues order rejecting Carriers' 2005 TSM-set rates because Carriers failed to supply cost-of-service support required in Order 151. Order P-05-1(1). *Order Rejecting 2005 Intrastate TAPS Settlement Methodology Rates*, dated December 30, 2004. (Exh. A/T-135)

12/16/05 RCA issues order rejecting Carriers' 2006 TSM-set rates because Carriers failed to supply cost-of-service support required in Order 151. Order P-06-1(1). *Order Rejecting 2006 Intrastate TAPS Settlement Methodology Rates*, dated December 16, 2005. (Exh. A/T-136)

12/28/06 RCA issues order rejecting Carriers' 2007 TSM-set rates because Carriers failed to supply cost-of-service support required in Order 151. Order P-07-1 (1). *Order Rejecting 2007 Intrastate TAPS Settlement Methodology Rates*, dated December 28, 2006.

APPENDIX C

GLOSSARY

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GLOSSARY

ADIT	Accumulated Deferred Income Tax
AFUDC	Allowance for Funds Used During Construction
ANS	Alaska North Slope
APB	Allowance Per Barrel
APUC	Alaska Public Utilities Commission, predecessor to Regulatory Commission of Alaska (RCA)
AS	Alaska Statutes
Carriers or TAPS Carriers	Oil pipeline companies that directly own an interest in the Trans-Alaska Pipeline System and are a party in this proceeding
Chicago, Milwaukee	*Chicago, Milwaukee, St. Paul & Pacific R.R. Co. v. Illinois*, 355 U.S. 300 (1958)
DOC	Depreciated Original Cost rate-making methodology
DOE	Department of Energy
DR&R	Dismantlement, Removal and Restoration
FERC	Federal Energy Regulatory Commission
Florida I	*Florida v. United States*, 282 U.S. 194 (1931)
Florida II	*Florida v. United States*, 292 U.S. 1 (1934)
ICA	Interstate Commerce Act, 49 U.S.C. § 1 *et seq.* (1976), reprinted in 49 U.S.C. app. § 1 *et seq.* (1988)
ICC	Interstate Commerce Commission
Interstate Settlement Agreement	1985 Interstate Settlement Agreement between Carriers and State of Alaska (Exh. A/T-33)
Intrastate Settlement Agreement	1986 Intrastate Settlement Agreement between Carriers and State of Alaska (Exh. A/T-34)

IRR	Internal Rate of Return (*see* Order 151 at 24)
King	*King v. United States*, 344 U.S. 254 (1952)
Louisiana	*United States v. Louisiana*, 290 U.S. 70 (1933)
Mississippi	*Mississippi Pub. Serv. Comm'n v. United States*, 349 U.S. 908 (1955)
North Carolina	*North Carolina v. United States*, 325 U.S. 507 (1945)
Opinion 154-B	*Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985)
Order 151	Order Rejecting 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates, Requiring Refunds and Filings; and Outlining Phase II Issues, RCA Order P-97-4(151)/P-97-7(110), dated November 27, 2002
Petition	Carriers' Section 13(4) petition filed July 20, 2005
RCA	Regulatory Commission of Alaska
SAC	Carriers' Stand-Alone Cost benchmark
Section 13(4)	Section 13(4) of the Interstate Commerce Act, 49 U.S.C. app. § 13(4)
SRB	Starting Rate Base (*see* Opinion 154-B)
TAPS	Trans-Alaska Pipeline System
TOC	Trended Original Cost rate-making methodology (*see* Opinion 154-B methodology)
TSM	TAPS Settlement Methodology contained in the Interstate Settlement Agreement and the Intrastate Settlement Agreement
Utah	*Pub. Serv. Comm'n of Utah v. United States*, 356 U.S. 421 (1958)

CERTIFICATE OF SERVICE

I hereby certify that I have served this day copies of the foregoing on the official service list compiled by the Office of the Secretary in accordance with Rule 2010 of the Commission Rules of Practice and Procedure.

Dated at Washington, D.C. this 16th day of February, 2007.

/s/
William D. Booth

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2/16 Initial Briefing
John Katz - FERC ATTY

5 commissioners

~~[illegible]~~
(3/21) —

May 18th — Admin. Judge Ruling
30 days

20 days

1985 - TAPS
2002

State & FERC Comm. staff - in agreement -
Kate Giard - GIERD

For RCA FERC Council - Carmen Gentille
~~1985 TAPS~~
~~2002~~

1 obice - Protection of sover. of St. of A for setting rates for oil trans.
Preserving authority of SOA that set rates - trans

TAPS Carriers - brought case -
upset w/ ruling
TOOL tracing - Bl4 Sec 13.4 Interstate Comm. Act.
chiefly applied to Railroad traffic - ICC right to determination

Carmen Gentille –
IntrA State shippers – unfair adv.
over Interstate shippers.

Discrimination, unfair adv.
State rates so low –

ICC 13.4 – never applied to oil trans.

Hypo. evidence –
→ No Actual cost of service were submitted –
no way to determine.

no contention w/interstate rate
→ have contention w/intrAState rates w/regard
Acc depreciation taken.

Steven Brose – Stepdoe & Johnson, law firm
in D.C.

Interstate – 1985
set a ceiling
emphasize – status of what it stands today
early stages – final decision is far
from over. Premature to elaborate.
→ We will be responding quite vigorously with
FERC staff's briefing on 3/21
Comm. approved settlement 1985 –

DISCRIMINATION CLAIM -

Phil Reeves - AK Dept of law - Asst AG

Oil, Gas + Mining -

DoL Managers in the case

- in the midst of briefing -

2005 + 2008 Rates - States right

Enforce a specific part of the agreement -

Again, under I.C. Act. 13.4., sect. 2 + 3 -

Intra Rates lowered to Inter -

1.96 (4.00) carriers charges - Protest 2005

DOR - [illegible] a calc [illegible]

→ seeking to correct unjust

RCA0151 - still @ Supreme Court

~~[illegible]~~

Tariffs - wellhead value of the oil -

unjust discrimination -

FERC Staff Report - looked at cost - only Hyp - will

~~[illegible]~~ they have to show actual

Mark Hanley – ANADARKO –

Kip, Attorney –

11/27/02 – [illegible] Press Release –

INTRA 1.96 INTER +5.00 (2007)

22% @ Alpine

filed a case in 2004 on the Interstate rate.

Happy to have FERC's staff come out in support of our case – don't know what Comm. & Admin. judge

KIP KNUDSEN – [illegible] TESORO AK, EXTERNAL AFFAIRS MGR.

Bring all CI

(1) methodology –

(2) TSM meth. does not tease out just & reasonable rate

Robin Brenna – Presentation

Just & Reasonable rate 2.00 – 5.00
INTRA – INTER

amount over 2.00 – excess rate, each yr. they operate TAPS.

→

TSM – Rates –

Billion overcollected. RCA & FERC staff [illegible]

Did not elect to defend [illegible] rate – offered a proxy case – acc. deprec.

FERC's policies not suited for AK - multiple lines

Neg. TSM 2 - all ind. met w/State.

④ FAIR Deal - recoverable costs - once, not twice.

TERM ELEMENT - Determine whether it's a cost based.

Producer owned pipelines? Lower 48 - Generally main line is regulated - lots of segment lines. AK is different - Only 1 line.

Independent Producers - 1st thing to look at Open access to existing fac. w/in fields

Jones Act - only a few.

① John Iverson - Dept. of Rev., TAX Director
Joyce -
John Rush -
① 1 state revenue effects / FERC rates - (not tied to State's litigation.
2005 —— 2008 Run. 1/01/09 - State may renegotiate
State's share (~25% $818 million as refund rate
Tailor own assumptions to anything the Leg. wants.

John Iversen
Ran those #'s

Joyce – Refer to online
Used 10% ↓ lower than last forecast
Volume ↓

forecast of oil $ ↑ than in the fall.

model 2005 – [2007 – 2008] forecast out (speculate)
TSM model – historical #s. Diff between
~~[illegible]~~ + 2004 Rate

State's share @ 25% in 2010 with interest

PPT – in the middle of analyzing

Gutten?, pg. 24 #6 –

Gatto? DR + R – ~~[illegible]~~ none in calculation. SD the proceeds collected & the current balance.
Initial settlement – finite amount

John Rush – TSM allowed for I.S.B. over the life of the ___ + interest

Thernault

model -
Did not anticipate DR&R is overcollected
Didn't factor that in -

☆ Outline of the Dept. of Revenues model
they just ran -
↳ They can provide that

Potentially significant to the States' Treasury.