

LEG. FINANCE - BILLS 1977 - 1978 775

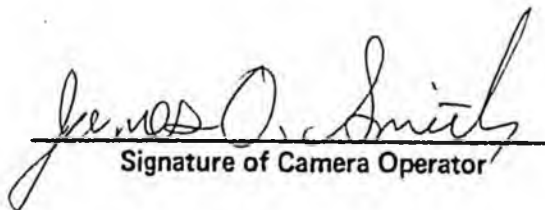
HB 648 cont. 775

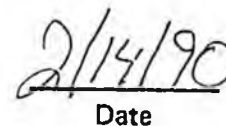


RECORDS CERTIFICATION



I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microform are accurate reproductions of the original records of the State of Alaska as accumulated during the regular course of business, and that it is the established policy and practice of this State to microfilm its records and to dispose of the original records after microfilm reproductions have been made.


Signature of Camera Operator


Date

COMMITTEE REPORT
SENATE

FURTHER: NONE

1/27/78

Date: January 31, 1978

Mr. President:

The Committee on FINANCE has had HB 648
special appropriation to Dept. of Law

under consideration and (a majority of the committee) (the committee reports it back as follows)

- recommends it do pass () recommends it do not pass
- () recommends it do pass with attached amendment(s)
- () recommends it be replaced with CS for _____
- and _____ () new title () same title
- () AND attaches a Letter of Intent () New Fiscal Note
- () reports it back without recommendation
- () and recommends it be referred to the _____ Committee

MEMBERS SIGNING DO PASS:

OTHER RECOMMENDATIONS:

[Handwritten signature]

[Handwritten signature]

[Handwritten signature]

[Handwritten signature]

[Handwritten signature]

[Handwritten signature]

Chairman

[Handwritten initials]

6.20

~~4.85~~

①. Accepted CO's figures but ...

②.

①. ICE auth without hearing report to suspend.
and go back ~~to~~ tell them to get down.

Final Tally in front of Kelly Aug. in Feb.

②. Line work in and \$2.0 m more.

Magnitudes: 4 m. sales retrieval - Sohio

③

958.3 requested for '78

Projected needs:

FY 79 1,047.0

FY 80 271.6

When will FY 79
funds be requested?

Introduced: 1/17/78
Referred: Finance

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE BILL NO. 648

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act making a special appropriation to the Depart-
7 ment of Law; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. The sum of \$958,300 is appropriated from the general fund
10 to the Department of Law for presentation of the state's position at ICC
11 tariff hearings.

12 * Sec. 2. The unexpended and unobligated portion of this appropriation
13 lapses into the general fund June 30, 1979.

14 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
15 10.070(c).

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STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K - STATE CAPITOL
JUNEAU 99811

X
JAY S. HAMMOND, GOVERNOR

August 5, 1977

The Honorable John C. Sackett
Alaska State Senator
P. O. Box 65
Galena, Alaska 99741

Dear John:

At the beginning of the next legislative session, I will bring to the legislature a request for a supplemental appropriation to this department to fund continued legal efforts before the ICC on pipeline tariffs. Because I can see this coming now and because the request will be substantial, I want to let you know about it as quickly as possible.

Thus far, adding up regular appropriations and supplemental appropriations, the department has received approximately \$385,000 to retain attorneys for the ICC proceedings. A substantial additional sum has been appropriated to the Alaska Pipeline Commission for investigation of costs incurred in pipeline construction. The funds for the Department of Law have been spent retaining a Washington, D. C. law firm, Donelan and Cleary. That firm has handled nearly all of the litigation to date, with the assistance of people in this office. As you know, the proceeding has been operating at two levels, the first being the investigation before the Alaska Pipeline Commission and the second being the presentation of the case before the ICC using information derived from the Alaska investigation. We have had at one time or another three attorneys assigned to the Pipeline Commission, since we have been constantly in court with Alyeska fighting over documents. To date, we have been very successful in combatting the efforts of the oil companies to withhold information from the investigation. We have also participated directly in the Washington proceedings and in related judicial proceedings which stem from the ICC decisions. For instance, Wil Condon and Rich Burnham of this office have been working constantly with Cleary's office preparing briefs, and I argued the appeal from the ICC decision to the 5th Circuit, which, as you probably know, resulted in a decision favorable to the state.

As we have gone along, it has become increasingly clear that we are in a mammoth proceeding, one that will take literally years and a great deal of money to complete. The oil companies are represented by more than eight law firms, all of which are going to make presentations before the ICC. The firms the companies have retained are some of the largest and the most prestigious in the country. To counter that effort, we have had to spend an increasing amount of time, and now it appears that we are going to require substantial additional funds. We originally thought that this hearing might take up to a year to complete. Now it is clear that only the first phase of the hearing may be done within a year and that we are going to be involved in a battle every inch of the way throughout that year and for the two or three years that follow, including numerous appeals to the courts. I estimate now that it is going to cost us an additional one to two million dollars in legal fees and fees for expert witnesses to adequately meet the arguments advanced by the oil companies.

The stakes, as you know, are enormous. We just were successful in having the ICC suspend tariffs originally filed by the companies for a period of seven months, the limit of the suspension power of the agency. That decision alone will result in perhaps 100 million dollars extra for the state treasury and it is only the tip of the iceberg. If we were to simply sustain the level of tariffs we have already achieved before the Commission, we would receive in excess of 120 million dollars per year additional over the entire length of the field, a total reaching into the billions of dollars. Unfortunately I was unable to take this case on a contingent fee basis. Be that as it may, the point I am trying to make here is that an expenditure of one million or two million extra dollars in legal costs is inconsequential in light of the money we will ultimately gain from the proceeding. The results to date should be evidence enough of that. Moreover, the money we spend, I venture to guess, will be but a minor share of that spent by our opponents in the proceeding.

Since the last legislative session, it has become clear that the one Washington firm we had retained is simply not sufficient to handle the tremendous volume of work generated by this case. I have made tentative arrangements to add a second firm--Wald, Harkrader and Ross--to the effort. Terry Lenzner of that firm has already been involved in the pipeline investigation, and their work is of top quality. We have received a preliminary budget from that firm and from John Cleary's firm which indicate that the

August 5, 1977

ultimate legal costs will be in excess of one million dollars for the two firms and for expert witnesses necessary to the presentation of the case. I have told both firms of the limits of our present legislative appropriation and I have cautioned them that until the legislature acts there is no way I can guarantee to them that there will be additional funds available to pay the legal costs. At the same time, I have assured them that I would take steps to see that at the commencement of the legislative session, the Governor would introduce a supplemental appropriation so that the legislature could make its decision as to whether it wanted to fund the effort further before we ran up substantial additional costs beyond the present appropriation.

I will have more complete information for you, including the estimates of the various firms, when you convene in January, or sooner if you desire. What I would like to ask you to do at this time is to give me an assurance that you will take up our request for an appropriation at the earliest possible time after the legislature convenes. If you do not want to fund the effort, so be it, but the one thing that we cannot afford is a state of uncertainty for four or five (or six or seven?) months. I can ask the firms to ride with us until January, but I cannot in good conscience ask them to sit out the entire legislative session for a decision on whether or not they will get paid. I frankly cannot conceive that you would not want to fund the effort, considering the results to date, but it is nonetheless your decision. I only would like to be able to assure the law firms that you will make that decision quickly in January.

I will be happy to send you any further information you desire prior to the session so that you can be fully briefed on this issue when the session opens. I really feel it is imperative that I be able to make a commitment of prompt action to the law firms involved, because I could not in good faith ask them to work without any guarantee of repayment beyond January. Last session the supplemental appropriation for the legal work did not clear the legislature until the closing days, and I simply wanted to try to avoid that if at all possible next session.

Thanks for your consideration.

Yours very truly,



Avrum M. Gross
Attorney General

AMG:as

P.S. I have spoken to Keith Miller who was going to contact me as soon as he could find the opinion on cease and desist orders you told me about. Haven't yet heard back?

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K - STATE CAPITOL
JUNEAU 99311

August 5, 1977

The Honorable Steve Cowper
Alaska Representative
210 Nerland Building
Fairbanks, Alaska 99701

Dear Steve:

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August 5, 1977

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Thanks for your consideration.

Yours very truly,



Avrum M. Gross
Attorney General

AMG:as

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K - STATE CAPITOL
JUNEAU 99811

August 19, 1977

*Jan
file
future use*

The Honorable Jay S. Hammond
Governor
State of Alaska
Pouch A
Juneau, Alaska 99811

Re: Trans-Alaska Pipeline - Interstate
Commerce Commission Proceedings

Dear Governor Hammond:

As you know, on June 28, 1977, the Interstate Commerce Commission entered an order suspending the initial tariff filed by seven of the eight Trans-Alaska Pipeline System (TAPS) owners. (Phillips Alaska Pipeline Corporation filed a tariff with a different effective date than that of the other seven owner companies and its tariff was therefore suspended by a subsequent order of the Commission separate from that which addressed the tariffs of the other seven owner companies.)

In addition to suspending the initial tariffs, the Commission's June 28 order stated the maximum tariffs based on the evidence submitted by the owners, that it would permit to go into effect pending final resolution of the tariff proceedings. The effect of the Commission's order was to reduce the initial TAPS tariffs by an overall average of \$1.35.

The owners subsequently appealed the Commission's order to the United States Court of Appeals in Houston, Texas. The issues raised by the appeal were (1) whether the Commission has the statutory authority to suspend the first tariffs filed by a carrier; and (2) whether the Commission has the statutory authority to indicate, without a full evidentiary proceeding, the maximum tariffs it will permit to go into effect prior to completion of the tariff case. Involved in the appeal were the eight owners and, on the other side, the State of Alaska, the Department of Justice, the Bureau of Investigations and Enforcement of the Interstate Commerce Commission and the Arctic Slope Regional

Corporation. I argued the State's case to the Court of Appeals and I was therefore very pleased when that court ruled in our favor on both issues, finding that the Commission has the authority to suspend first filed tariffs and the authority to indicate the maximum tariffs it will accept pending a full evidentiary proceeding.

The Commission's power to suspend initial tariffs is limited to seven months. At issue before the Commission at the moment is whether that seven month period begins to run from the effective date of the tariffs or from the date oil was first transported through TAPS. It is our position that the seven month period begins running on the latter date. If the Commission agrees, suspension of the TAPS tariffs will terminate in late February, 1978. Should the Commission rule in favor of using the effective date, the suspension period will end in late January.

Under the Interstate Commerce Commission Act, if the evidentiary proceedings with respect to the suspended tariffs are not completed by the end of the seven month suspension period, the tariffs now under suspension automatically, would go into effect pending the completion of the tariff proceedings and the issuance of a final order by the Commission setting permanent tariffs. Given the fact that completion of these proceedings is probably two years or more down the road, the possibility exists that the presently suspended tariffs will be in effect for much of the next two years.

In order to overcome that possibility, the State and the Department of Justice jointly proposed to the Commission that the TAPS tariff proceedings be conducted in two phases, a proposal which the administrative law judge responsible for the case has accepted. Phase I will address the issues which we believe can be resolved relatively quickly. Those issues include:

- (1) Whether the rate base will be a valuation rate base or an original cost less depreciation rate base;
- (2) the rate of return the owners are to be allowed;
- (3) treatment of taxes;
- (4) method of calculation of total revenue needed by the owners to meet their annual expenses.

At the conclusion of hearings on the issues to be addressed in Phase I, we will ask the Commission to set an interim tariff based on the results of Phase I.

Following the setting of an interim tariff, the legality of which we expect the carriers to challenge in court, the hearings will begin on Phase II. The issues to be addressed in Phase II will include:

(1) Cost overruns, using the Lenzner report as the basis;

(2) Depreciation (This issue will necessarily include a determination of the amount of recoverable reserves on the North Slope and in surrounding areas. The larger these reserves, the longer the depreciation of TAPS, and the lower the tariff.)

At the conclusion of the Phase II proceedings, the Commission will set the permanent tariff.

Under the hearing schedule for Phase I, established by order of the judge, the owners will present their case first, beginning October 12, 1977. The State and all others who protested the initial tariffs will be required to present their evidence beginning sometime in early December, 1977. According to the schedule, the submission of the evidence on the issues addressed in Phase I would be completed and those issues ready for a decision by the Commission sometime in March, 1978. I expect the owners will appeal this schedule to the full Commission any day and I would guess that we will get a decision of that appeal sometime prior to Labor Day.

One of a number of unknowns in the proceedings at this time is what effect President Carter's Department of Energy legislation, signed by the President on August 4, 1977, will have on these proceedings. This legislation provides that within 120 days from the effective date of the bill, all ICC oil pipeline jurisdiction is to be transferred to the newly-created Federal Energy Regulatory Commission, which is basically the old Federal Power Commission transferred to the Department of Energy. At this point, we really don't know what the effect of the transfer to the Department of Energy will be, nor are we sure at this point exactly when the transfer will take place, though an assistant to Secretary Schlesinger, at the American Bar Association convention last month, stated that he expected the transfer to be completed by October 1, 1977.

At the outset of the TAPS case, the State was represented by this office and by John Cleary of the Washington, D.C. law firm of Donelan, Cleary, Wood & Maser. Mr. Cleary has had extensive experience practicing before the ICC and I think our success to date confirms his ability. Recently I hired William Ross of the Washington, D.C. law firm of Wald, Harkrader and Ross to assist ourselves and Mr. Cleary. There are two reasons I did so. First, Mr. Ross's firm, of which Terry Lenzner is also a partner, is a larger firm than Mr. Cleary's and has the greater resources which will be necessary to present the TAPS case. Second, Mr. Ross has had extensive experience practicing before the Federal Power Commission. Given the impending transfer of the TAPS case to the Federal Energy Regulatory Commission of the Department of Energy and the fact that that Commission is essentially the old Federal Power Commission, I believe Mr. Ross's participation as co-counsel with Mr. Cleary will be extremely advantageous.

I expect at this time that the development and presentation of the State's TAPS case will cost a total of \$1.5 million to \$2 million, substantially higher than initially planned. The reason for the increase centers on the State's greatly increased chances of success. Initially, we were very pessimistic about the possibility of the ICC substantially reducing the owners' tariffs. The Commission's record has been one of almost rubber stamping carrier tariffs and therefore, though we did expect to have the tariffs reduced by some amount, we did not expect the reduction to be by more than a few cents, notwithstanding a major effort on behalf of the State.

Since proceedings before the Commission began, however, it has become evident that the Commission intends to use the TAPS case as the vehicle to completely rethink the issues relating to pipeline regulation. Our great success to date indicates that the Commission intends to decide the issues in this case far differently from in the past.

With the transfer of the case to the Department of Energy, we will be working with a clean slate. It will therefore be even more important for the State to acquire the services of the finest attorneys, economists and financial experts possible in order to assure that what is subsequently written on the slate is as favorable to Alaska as possible.

August 19, 1977

I realize that a figure of \$1.5 to \$2 million sounds like a tremendous amount for the presentation of a case, and in fact it is. Yet, that figure must be placed in perspective by comparing it to the amount of money Alaska may gain through the TAPS case. As you know, each penny the tariffs are reduced increases the State's revenue by about \$1 million a year. In other words, the \$1.35 reduction of the tariffs to date, if carried over one year, will mean an increase in revenues for Alaska of about \$135 million a year. If that reduction were to hold for the 25 years the owners say TAPS will be in operation, the ultimate gain to Alaska would be around \$3,375,000,000. Obviously, it is worth investing at least a couple of million dollars when we have a reasonable chance to gain so much.

Yours very truly,



Avrum M. Gross
Attorney General

AMG:RMB:jec

STATE
of ALASKA

MEMORANDUM

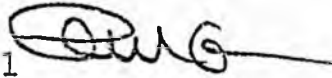
TO: The Honorable Steve Cowper
Chairman
House Finance Committee

DATE: January 19, 1978

FILE NO:

and

TELEPHONE NO:

~~XXX~~ The Honorable John Sackett
Chairman
Senate Finance CommitteeSUBJECT: TAPS Interstate
Tariff ProceedingsFROM: Avrum M. Gross 
Attorney General

Attached is a summary of our activities to date on the TAPS interstate tariff proceedings, including a breakdown of the funds needed to complete the effort. The special appropriation in excess of \$900,000 presently before the House Finance Committee is derived by taking the estimated legal expenses for FY 78 (\$352,500) and subtracting from it the monies already appropriated to this department (\$368,616) for use.

I will be available at the House Finance Committee to answer any questions the committee may have tomorrow, but I wanted you to have as complete a background as possible.

AMG:as
Attachment

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

JAY S. HAMMOND, GOVERNOR

POUCH K - STATE CAPITOL
JUNEAU 99811

October 24, 1977

The Honorable J.S. Hammond
Governor
State of Alaska
Pouch A
Juneau, Alaska 99811

Dear Governor Hammond:

The beginning of the hearings on the Trans-Alaska Pipeline System (TAPS) tariffs is fast approaching with the carriers required to file their testimony on November 30, 1977 and hearings for the cross-examination of carrier witnesses to begin on January 10, 1978. Many of the uncertainties which previously existed have been eliminated and we feel we are now in a position to present to you a reasonably accurate estimate of the cost of presenting the State's case.

Our best estimate is that the total cost of presenting the remainder of the State's case will be \$2.3 million. A breakdown of expenses is contained in the attached schedule. Those funds should be appropriated as continuing fund special appropriations in the amounts of \$958,284 for FY 78, \$1,047,000 for FY 79 and \$271,600 for FY 80.

We are well aware that the estimated cost is very substantial. But, as noted in my letter to you of August 19, 1977, the stakes in the TAPS case are enormous. The difference between our previous cost estimate and the \$2.3 million figure is mostly attributable to two factors. First, we did not initially plan to engage the services of a second Washington D.C. law firm (Wald, Harkrader & Ross). Our need for a law firm with extensive resources and expertise in managing cases of the magnitude of TAPS, however, made the hiring of a second law firm necessary. Because Terry Lenzner of Wald, Harkrader & Ross conducted the investigation of TAPS cost overruns for the Alaska Pipeline Commission, that firm was the logical choice.

The Honorable J.S. Hammond
Governor
October 24, 1977
Page 2

A second factor which has increased our estimate is the extensive amount of litigation which the TAPS case has engendered to date. Simultaneously with the proceeding before the Interstate Commerce Commission, and now before the Federal Energy Regulatory Commission, we have had to respond to suits by the carriers in three different Courts of Appeals and in the United States Supreme Court. The Supreme Court's recent grant of a stay of the ICC's suspension order pending a decision by the Court as to whether it will hear the merits of the carriers' appeals indicates litigation will continue to constitute a substantial portion of the costs of the TAPS case.

I think it is fair to say that given the billions of dollars involved in the TAPS case, the carriers have decided that it is worth it for them to litigate to the fullest every issue on which there is any doubt. Unless the State is willing to meet them with a similar attitude, the carriers may ultimately prevail on an issue worth multi-billions of dollars simply because we don't make an adequate effort. We have prevailed on nearly every issue to date against the biggest oil companies and law firms in the world, and I don't want to see us lose in the end through lack of commitment.

Sincerely,

Avrum H. Gross
Attorney General

RMB:syh

cc: Ron Lind
Kent Dawson

SUMMARY OF PROJECTION OF COSTS TO STATE
OF TAPS INTERSTATE TARIFF PROCEEDINGS

TOTALS

Legal fees	\$1,901,300
Expert consultants	. 685,000
Expenses	68,000
Transcript of proceedings	<u>21,400</u>
Sub-Total:	\$2,675,700
Less funds available for TAPS case	<u>-368,616</u>
TOTAL:	<u><u>\$2,307,084</u></u>

PROJECTION OF COST TO STATE
OF TAPS INTERSTATE TARIFF PROCEEDINGS

Fiscal Year 1978

I. Phase I.

A. Issues

1. Rate base
2. Rate of return
3. Treatment of taxes
4. Method of calculating total revenue

B. Cost Projection (assumes Phase I will be completed during FY '78)

Expert Consultants		\$225,000
Wald, Harkrader & Ross		\$338,500
Lawyers - 3500 hours at an average of \$85 per hour	297,500	
Legal assistants - 1200 hours at \$30 per hour	36,000	
Expenses	5,000	
Donelan, Cleary, Wood & Maser		\$284,200
Lawyers - 3400 hours at an average of \$68 per hour	231,200	
Legal assistants - 1200 hours at \$25 per hour	30,000	
Expenses	15,000	
Transcript of proceed- ings	8,000	

TOTAL:

\$847,700

II. Phase II.

A. Issues

1. Cost of construction
2. Depreciation
3. Cost of removal
4. Any other issues which may arise

B. Cost Projection (assumes this phase moves into discovery and substantial pre-hearing analysis during FY '78)

Expert Consultants		\$100,000
Wald, Harkrader & Ross		\$302,000
Lawyers - 2800 at an average of \$85 per hour	238,000	
Legal assistants - 1800 hours at \$30 per hour	54,000	
Expenses	10,000	
Donelan, Cleary, Wood & Maser		\$ 77,200
Lawyers - 900 hours at an average of \$68 per hour	61,200	
Legal assistants - 500 hours at \$25 per hour	12,500	
Expenses	3,500	

TOTAL:

\$479,200

Fiscal Year 1979

Phase II.

Expert Consultants		\$300,000
Wald, Harkrader & Ross		\$439,000
Lawyers - 4400 hours at an average of \$85 per hour	374,000	
Legal assistants - 2000 at \$30 per hour	60,000	
Expenses	5,000	
Donelan, Cleary, Wood & Maser		\$308,200
Lawyers - 3600 hours at an average of \$68 per hour	244,800	
Legal assistants - 1200 hours at \$25 per hour	30,000	
Expenses	20,000	
Transcript of proceed- ing	13,400	
TOTAL:		\$1,047,200

Fiscal Year 1980

Phase II.

Expert Consultants		\$ 30,000
Wald, Harkrader & Ross		\$152,500
Lawyers - 1700 hours at an average of \$85 per hour	144,500	
Legal assistants - 200 hours at \$30 per hour	6,000	
Expenses	2,000	
Donelan, Cleary, Wood & Maser		\$ 89,100
Lawyers - 1200 hours at an average of \$68 per hour	81,600	
Expenses	7,500	
TOTAL:		\$271,600

Assumptions:

1. Consultants' expenses payable out of consultants' budget.
2. Expenses do not reflect costs of computer retrieval system which may be used in Phase II.
3. Hours projected assume only one level of briefing before the Federal Energy Regulatory Commission and do not cover any court proceedings.

PROPOSED BUDGET FOR TAPS
INTERSTATE TARIFF PROCEEDINGS

In July, 1977, North Slope oil began to flow into the Trans Alaska Pipeline System ("TAPS"). The State's tax and royalty payment receipts from North Slope oil production vary inversely with the tariffs charged by the TAPS owners^{1/} to transport the oil to Valdez. In other words, the higher the tariff, the lower the receipts to the State. After review of the tariffs filed by the TAPS owners, and consultation with regulatory counsel and technical experts, the Department of Law concluded that the tariffs are excessive and will unreasonably deprive the State of funds which it vitally needs. Tariffs from the interstate pipeline transportation of oil -- which constitutes most of the TAPS transportation -- are subject

1/ The present percentage ownership interests are as follows:

<u>Party</u>	<u>Percentage of Ownership</u>	<u>Design Capacity (Bbls./Day)</u>
ARCO	21.00%	252,000
Sohio	33.34	400,080
Exxon	20.00	240,000
Amerada Hess	1.50	18,000
Mobil	5.00	60,000
Phillips	1.66	19,920
Union	1.66	19,920
BP	<u>15.84</u>	<u>190,080</u>
TOTAL	100.00%	1,200,000

to exclusive federal regulatory jurisdiction.^{2/} The Department has therefore been participating in several federal court and administrative proceedings in an effort to secure a reduction of the filed TAPS tariffs.

The Department's efforts to reduce the interstate TAPS tariffs have proceeded on two principal fronts. First, the Department has filed and pursued protests and related court proceedings seeking, in effect, to have the filed rates suspended and reduced as clearly excessive on their face. Second, the Department has become a party to federal administrative proceedings established to investigate the reasonableness of the filed tariffs. A summary of the Department's activities on the State's behalf on these two fronts reflects the magnitude of the effort that has been expended to date and the extent to which resources must be committed in order to continue to pursue the State's best interests in these matters.

A. Activities to Date

Between May 31, 1977 and June 20, 1977 the eight TAPS owners filed initial tariffs for the transportation of crude oil through TAPS. On June 15, 1977, the State of Alaska, as well as the Department of Justice, the Bureau of Investigations

^{2/} Intrastate tariffs are subject to the jurisdiction of the Alaska Pipeline Commission. Proceedings are currently underway in that forum with regard to the intrastate tariffs filed by the TAPS carriers.

and Enforcement of the ICC, and the Arctic Slope Regional Corporation filed protests seeking the suspension of the initially filed tariff rates and an investigation of their lawfulness.^{3/}

On June 28, 1977, following a full day of oral argument in which the State's counsel participated, the ICC suspended the proposed rates for the seven month statutory period, without prejudice to the filing of interim rates upon not less than one day's notice, and set forth maximum interim rate levels which would meet the Commission's standard of reasonableness.^{4/} The Commission placed both the proposed tariffs and any subsequent tariffs filed during the seven month period under investigation. Any interim tariffs filed were required to contain a refund provision. Thus, if such interim rates subsequently were found to be excessive, the carriers would be required to refund the excess plus interest. A similar refund provision was made applicable to the original proposed rates.

^{3/} Protest And Petitions for Suspension by the United States Department of Justice, June 15, 1977; Protest/Complaint of The State of Alaska Seeking the Suspension and Investigation of Initial Rates and Tariff Provisions, June 15, 1977; Protest and Petition of The Bureau of Investigations and Enforcement for Suspension and Investigation, June 15, 1977; Protest and Petition for Suspension of Initial Rates and Tariffs, by the Arctic Slope Regional Corporation, June 13, 1977.

^{4/} Order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 9164, Trans Alaska Pipeline System (Rate Filings) and No. 36611, Trans Alaska Pipeline System (Rules and Regulations), June 28, 1977.

Some of the carriers sought judicial review of the Commission's decision in the U.S. Court of Appeals for the Fifth Circuit.^{5/} Following oral argument, in which Attorney General Gross participated, the Court dismissed the appeal.^{6/} It held that the ICC had the authority to suspend an initial rate, that the Commission's suggestion of maximum interim rate levels was permissible, and that a refund provision was permissible. It concluded, therefore, that the Commission had acted lawfully.

Several carriers then filed motions in the Supreme Court for a stay of the Fifth Circuit decision.^{7/} Four of

^{5/} Mobil Alaska Pipeline Co. v. United States, No. 77-2392, (July 6, 1977); BP Pipelines, Inc. v. United States, No. 77-2412 (July 8, 1977); Exxon Pipeline Co. v. United States, No. 77-2421 (July 11, 1977); ARCO Pipe Line Co. v. United States, No. 77-2437 (July 14, 1977). In No. 77-2392, Sohio Pipe Line Company, Amerada Hess Pipeline Corporation, and Union Alaska Pipeline Company were intervening petitioners while the State of Alaska and the Arctic Slope Regional Corporation were intervening respondents. In No. 77-2421, Union Alaska was an intervening petitioner. In No. 77-2437, the State of Alaska was an intervening respondent. Phillips Alaska Pipeline Corporation sought judicial review in the District of Columbia Circuit.

^{6/} Mobil Alaska Pipeline Co. v. United States, 557 F.2d 775 (1977).

^{7/} Mobil Alaska Pipeline Co. v. United States, No. 77-452 (Sept. 21, 1977); Exxon Pipeline Co. v. United States, No. 77-457 (Sept. 22, 1977); BP Pipelines, Inc. v. United States, No. 77-551 (Oct. 12, 1977).

the carriers also filed petitions for writs of certiorari.^{8/} On October 20, 1977, the Court granted a stay^{9/} and further explained the stay in an Order dated November 14, 1977.^{10/} The stay was conditioned upon petitioner's agreement to keep account of the amounts collected under the proposed rates and to refund, with interest, any portion of the amounts collected if it were to be ultimately determined that the carriers were not lawfully entitled to collect those amounts. On November 28, 1977, the Supreme Court granted the certiorari petitions and consolidated the cases. The State will participate actively in the briefing and argument of these cases.

The Court is expected to hear and resolve the cases by July, 1978. If the State's position is sustained, the tariffs will be reduced retroactively by an average of \$1.35 per barrel over a period of about four months. This would result

^{8/} Id.; see also ARCO Pipe Line Co. v. United States, No. 77-602 (Oct. 25, 1977).

^{9/} Order of October 20, 1977 in Mobil Alaska Pipeline Co. v. United States, No. 77-452; Exxon Pipeline Co. v. United States, No. 77-457; BP Pipelines, Inc. v. United States, No. 77-551, 46 U.S.L.W. 3289 (U.S. Nov. 1, 1977). ARCO filed its Motion for Stay on October 21, 1977. See Application for Stay of Order, ARCO Pipe Line Co. v. United States, No. 77-602 (Oct. 21, 1977).

^{10/} Order of November 14, 1977 in Mobil Alaska Pipeline Co. v. United States, No. 77-452; Exxon Pipeline Co. v. United States, No. 77-457; BP Pipelines, Inc. v. United States, No. 77-551; ARCO Pipe Line Co. v. United States, No. 77-602, 46 U.S.L.W. 3321 (U.S. Nov. 15, 1977).

in increased revenues to the State of about \$25 million for that period. However, even if the State does not prevail in the Supreme Court case, the rates may be retroactively reduced as a result of the administrative investigation which the Interstate Commerce Commission initiated on July 7, 1977. If found unreasonable, the tariffs would be reduced to a reasonable level and refunds made for the excess amounts charged to date since TAPS oil began to flow. For example, a finding by FERC that rates in excess of \$4.00 per barrel are unreasonable would produce additional State revenues of about \$200 million per year.

The Commission initially assigned the TAPS tariff investigation to Administrative Law Judge Robert Glennon. After the first prehearing conference, Judge Glennon requested that all parties submit memoranda on the issues to be heard and procedures to be followed. On August 8, 1977 the State of Alaska and the Department of Justice submitted a joint memorandum asserting that a complete record on the proper method for determining a rate base must be developed in this proceeding.^{11/} The State and the Justice Department also proposed that the proceeding be phased because of its expected

^{11/} Joint Memorandum of the State of Alaska and the United States Department of Justice On The Issues And Procedures, Trans Alaska Pipeline System (Rate Filing): Investigation and Suspension Docket No. 9164, Trans Alaska Pipeline System (Rules and Regulations), Dkt. No. 36611, submitted August 8, 1972.

length and complexity, and requested that the carriers be required to go forward with their evidence in the first phase of the case. The TAPS carriers opposed these proposals.

After another prehearing conference, Judge Glennon issued his rulings on August 16, 1977.^{12/} He accepted the State's argument that the protesting parties should not be precluded from presenting facts or arguments intended to establish the validity of a rate base other than one proposed by the carriers. As the Judge concluded, "to allow these proceedings to be 'open' on the issue of rate of return, while 'closed' on rate base, would be an irrational, impermissible inconsistency." (Prehearing Order at 7).

Judge Glennon also adopted the phasing proposal of the State of Alaska and Department of Justice and ruled that the Commission has the authority to issue an interim rate order before concluding its full hearing on every issue presented in the case. He concluded that "the issues [are] sufficiently distinct and separable that a separate trial may be held without injustice." (Prehearing Order at 12). He therefore ruled that the proceedings would be phased as follows (Prehearing Order at 16):

^{12/} Report and Order on Prehearing Conference, Investigation and Suspension, Dkt. No. 9164, et al., Trans Alaska Pipeline System, August 16, 1977 [hereinafter cited as "Prehearing Order"].

a. Phase I. The issues of rate base, rate of return, treatment of taxes, and method of calculating total revenue will be adjudicated in Phase I. For the purposes of Phase I, protestants will not challenge the amounts claimed by respondents for construction or operating costs, depreciation charges, and removal costs.

b. Phase II. Questions concerning the allowable nature of TAPS expenditures as prudent investment, depreciation charges, removal costs, and all other issues not adjudicated in Phase I will be decided in Phase II.

On October 1, 1977, pursuant to the provisions of the Department of Energy Organization Act, Pub. Law 95-91, 91 Stat. 565, and Executive Order No. 12009, 42 Fed. Reg. 46267 (September 15, 1977), the functions and regulatory responsibilities of the Interstate Commerce Commission with respect to the establishment of rates and valuations for oil pipelines were transferred to the Federal Energy Regulatory Commission ("FERC"). Under the savings provision in Section 705(a) of the Act, the TAPS tariff proceeding will continue to be governed by the Interstate Commerce Commission's Rules and Regulations as promulgated in Title 49, Code of Federal Regulations, unless and until new regulations are promulgated. Thus, the issues in the TAPS proceeding were not substantively or procedurally affected by the transfer. However, the transfer did result in assignment of a new Administrative Law Judge, Max L. Kane, to preside at the proceeding. Judge Kane was one of the senior administrative law judges at the Federal Power Commission prior to the transfer of that Commission's duties to FERC.

B. The State's Future Role in the TAPS Proceedings

The Department believes that the State of Alaska should continue to vigorously pursue the issues it has raised before the Supreme Court and the Federal Energy Regulatory Commission. The State has a very large stake in the outcome of these proceedings. A reduction of one cent in the tariff filed by the carriers (which varied between \$6.04 and \$6.44 per barrel) means additional revenue of \$876,000 each year to the State because, as noted above, the State's tax and royalty interest receipts from TAPS production vary inversely with the size of the tariffs. As previously noted, the Interstate Commerce Commission has already indicated that the tariffs are excessive by at least \$1.35 per barrel.

Furthermore, in our judgment, it would be highly imprudent for the State to rely on the FERC staff or the Department of Justice to protect its interests, given the amounts at stake. While the FERC staff has not thus far taken issue with the State's position, its own case is at an early stage of development, and it is by no means certain that it will ultimately support the State on critical issues involving fair rate of return or cost disallowance. The interests of the Department of Justice in the proceeding are quite different from the State, involving rate setting principles and their views on competition, generally. Thus, the Justice Department cannot be relied upon to protect the State's financial interest in its taxes and royalties.

Although the legal issues currently before the Supreme Court are likely to be resolved within the next six months, the FERC proceeding promises to be much more complex and time-consuming. For example, the Department has concluded that the State should pursue the following factual and legal issues in Phase I of the FERC proceeding:

a. Whether TAPS⁴ should be regulated separately from other pipeline interests of the Owners.

b. Whether the use of a valuation rate base including reproduction costs new in determining pipeline rates is legally or economically justified:

1. whether the Congressional intent underlying inclusion of reproduction cost in the Section 19(a) valuation supports its continued use;

2. whether including reproduction cost as an element of the rate base is judicially favored;

3. whether most state and federal regulatory agencies have rejected the use of any element of reproduction cost in the rate base and have adopted an original cost less depreciation or similar standard;

4. whether the use of reproduction cost in the rate base produces arbitrary and unreasonable results and permits pipelines to recover almost two-fold for inflation;

5. whether the results of the use of condition percent are an additional reason for rejecting the Section 19(a) valuation as a rate base;

6. whether the use of a percentage additive for "going concern" value in the single sum valuation is an additional reason for rejecting the Section 19(a) valuation as a rate base; and

7. whether an original cost less depreciation rate base should be adopted.

c. Whether the TAPS rates should be determined in accordance with proper ratemaking principles:

1. whether the TAPS carriers are entitled to only a reasonable rate of return on an original cost rate base commensurate with the real risks of the enterprise;

2. whether for purposes of determining the appropriate rate of return, the Commission should employ either the actual capital structure of the carriers, or a hypothetical capitalization which reflects the financial and business risks of TAPS; and

3. whether if a valuation rate base is adopted, the rate of return should be adjusted accordingly.

d. Whether the TAPS tariffs properly reflect the treatment of taxes and the financial consequences of tax related investment incentives.

The issues to be litigated in Phase II of the proceedings have yet to be formulated in such detail and will, at least to some extent, be affected by the resolution of Phase I issues. It is already clear, however, that one of the principal Phase II issues will be whether all of the construction costs expended by the TAPS companies were prudently incurred. The companies insist that there were no imprudent

expenditures in constructing the project. However, a report to the Alaska Pipeline Commission by its Special Counsel, Terry F. Lenzner, concluded that TAPS construction costs were excessive by at least \$1.5 billion (out of a total of \$8 billion).

In Phase II of the FERC proceeding the State will pursue this question and present evidence showing massive excessive expenditures. If the Commission adopts the State's position, it will disallow such excessive costs in the rate base of the TAPS tariffs and reduce the tariffs accordingly -- both retroactively and prospectively.

The TAPS carriers have already presented their direct testimony on Phase I issues and Judge Kane has ordered cross-examination of their 31 witnesses to begin in early February. To protect the State's interests effectively, it will be necessary to cross-examine the testimony of the carriers' witnesses, then to prepare the rebuttal testimony and exhibits of those witnesses which the State will sponsor, and finally to submit briefs and proposed findings to the administrative law judge and the full Commission. Phase I should be completed by mid-1978 and shortly thereafter Phase II proceedings should begin. At the end of the FERC proceeding a record consisting of 100,000 transcript pages and 25,000 exhibits could easily be amassed.

C. Resources Required to Protect
the State's Interests

As the foregoing makes clear, the State has a very large stake in the outcome of very complex and time-consuming proceedings. The issues raised -- particularly in the FERC proceeding -- are numerous, highly specialized, novel, and require broad legal and economic expertise for adequate treatment. The Department recognizes that the State cannot hope to match the seemingly unlimited legal and consulting resources that the TAPS carriers have devoted to the proceeding. By the same token, however, merely sending observers to the proceeding or filing occasional pleadings is unlikely to have any impact at all on the outcome of the case.

The Department's in-house resources and expertise in these matters are, of course, quite limited. The Department has therefore retained the services of two Washington, D.C. law firms and several technical consultants. Their activities have been closely supervised by the Department and the Attorney General has assigned Assistant Attorney General Richard Burnham to maintain day-to-day liaison with the attorneys and consultants which we have retained.

The law firms appearing on the State's behalf are Donelan & Cleary and Wald, Harkrader & Ross. These firms have extensive experience in regulatory matters and have worked closely in representing the State in the administrative and judicial proceedings involving TAPS. The lead counsel in

these matters have been John M. Cleary, William Warfield Ross and Terry F. Lenzner. A brief description of their background and experience follows.

a. John M. Cleary. Mr. Cleary is a partner in Donelan, Cleary, Wood & Maser, a law firm of seven attorneys. He was born in Evanston, Illinois, in 1931 and received his law degree from Georgetown University in 1957, where he was a member of the law journal. Following graduation, he joined the firm of Pope, Ballard & Loos and became a partner of that firm in 1962. In 1966, he became a founding member of his present firm. During his 20 years of practice, Mr. Cleary has participated in numerous proceedings before the Interstate Commerce Commission as counsel to shipper-protectors. Among the proceedings have been the ICC's oil pipeline tariff rule-making proceeding (Ex Parte No. 308) and the Williams Brothers case, the first ICC case involving an oil pipeline to be litigated before the Commission since the 1940's. See Petroleum Products, Williams Bros. Pipeline Co., 355 I.C.C. 479 (1976) (appeal pending, D.C. Cir.).

Mr. Cleary is the past president of the Association of Interstate Commerce Commission Practitioners and is a member of the District of Columbia Bar.

b. William Warfield Ross. Mr. Ross is a partner in Wald, Harkrader & Ross, a firm of 60 attorneys. He was born in Washington, D.C. in 1926, graduated from St. John's College, Annapolis, Maryland in 1948 and from the Yale Law

School in 1951. After a period of private practice concentrating on water carrier regulatory matters, Mr. Ross served in the Truman and Eisenhower Executive Offices working principally on international civil aviation matters and miscellaneous coordination functions. Following a period of service in the Civil Division of the Department of Justice, Mr. Ross became Assistant to the Solicitor of the Federal Power Commission responsible primarily for litigation in the federal courts involving natural gas rate issues. Since 1959 he has been in private practice in Washington, D.C., concentrating on public utility and pipeline matters and federal energy and antitrust questions.

In 1963, Mr. Ross became a founding member of Wald, Harkrader & Ross and is the firm's senior practitioner in the utility and energy fields. He has been principally responsible for rate and licensing proceedings involving major utilities before the Federal Power Commission and Nuclear Regulatory Commission, including proceedings involving natural gas rate and certificate matters representing gas distributors and pipelines.

Mr. Ross has written widely on administrative law and energy matters, and is considered an expert on administrative procedure and practice. He has taught administrative law at Cornell University, and for many years has represented the American Bar Association before Congress on administrative

law and procedure legislation. He is currently serving as Chairman-Elect of the Administrative Law Section of the American Bar Association.

c. Terry F. Lenzner. Mr. Lenzner is a partner in Wald, Harkrader & Ross where his practice principally involves matters before the federal courts, administrative agencies and the U.S. Congress. After receiving his undergraduate and law degrees from Harvard University, he served for the next ten years in a number of important government positions. He initially served in the U.S. Department of Justice as a trial attorney and three years later he became Assistant United States Attorney in the organized crime unit of the southern New York district office. In 1969, he became director of the Legal Services Office of the Office of Economic Opportunity and, in that capacity, was responsible for supervision of all federally-funded legal service programs. After a short stint in private practice, he was appointed Assistant Chief Counsel of the Senate Select Committee on Presidential Campaign activities, popularly known as the "Watergate Committee."

Mr. Lenzner returned to private practice in 1974. His practice includes representation of the Cook Inlet Region, Inc. and the Alaska Pipeline Commission (APC), which he served as Special Counsel until August, 1977. As Special Counsel to the APC, Mr. Lenzner conducted an extensive investigation into

the excessive cost overruns in constructing the TAPS project. The results of that investigation were compiled in an 800-page report submitted to the APC last August.

In addition to legal expertise, it has been necessary to retain the services of a number of accounting, financial and engineering consultants to appear on the State's behalf in the FERC proceedings. These consultants include the following:

a. Technical Associates, Inc. This is an economics research and consulting firm with offices in Richmond, Virginia and Washington, D.C. The Department has retained its President, Dr. Michael J. Ileo, and other members of his firm who have extensive experience in public utility transportation and monetary economics and have frequently appeared as witnesses in federal and state rate regulatory proceedings. Dr. Ileo holds a PhD. in economics from Virginia Polytechnial Institute and has published several articles on utility and banking regulation.

b. VHS Associates, Inc. This is a California firm which provides construction management and engineering consulting services. The projects with which they have been associated include pipelines, marine terminals and harbors and oil processing facilities. The principal participant in the TAPS proceeding is VHS Vice President Egon K. Ellgaard, who has 20 years

construction management and staff experience. Mr. Ellgaard is a civil engineer and professional estimator, having received a MSCE degree from Stanford University in 1961. Recently, he has served as project manager for a federally-funded evaluation of alternative routes for transporting Prudhoe Bay natural gas to the lower forty-eight and served as a consultant to the Special Counsel of the Alaska Pipeline Commission in the TAPS construction overrun investigation.

c. Charles F. Phillips, Jr. Dr. Phillips is a professor of economics at Washington and Lee University and is an expert in the regulation of transportation and public utility industries. Among Dr. Phillips' many publications is The Economics of Regulation, recognized as a leading treatise in the area. He received his Ph.D. in economics from Harvard University in 1960 and during the last twenty years has frequently appeared as an expert witness before federal and state regulatory commissions.

d. Financial Management Associates. This consulting firm, located in Overton Park, Kansas, specializes in financial requirements of public utilities, particularly revenue requirements, rate design and rate of return issues. Members of the firm have been involved in numerous regulatory proceedings, including those before the Federal Power Commission and the Interstate Commerce Commission. The member of the firm primarily assigned to the TAPS case is John C. Dunn,

an economist who served as the Chief of the Department of Economic Research of the Missouri Public Service Commission prior to becoming an independent consultant.

e. Larkin, Chapski & Co. This is a certified public accounting firm registered to practice in Michigan, which has a combined practice of public accounting and utility regulation and consulting. In the area of utility regulation and consulting, the firm has participated in numerous rate cases before the Michigan Public Service Commission and in other jurisdictions. In addition, from April 1975 to March 1976, the firm contracted with the Michigan House of Representatives as Technical Staff Director of a Special House Committee to study and evaluate the effectiveness of the Michigan Public Service Commission and the rates and services of public utilities. Its reports to that Committee were adopted by the Committee in virtually all material reports in its final report and recommendation, and served as a basis of numerous bills introduced in 1976 and 1977 sessions of the Legislature. Messrs. Larkin and Chapski are providing assistance to the State primarily in the area of tax accounting.

D. Budget Requirements

To effectively participate in complex federal proceedings, and to retain the requisite expert assistance, is not inexpensive. The Department has developed and attached

hereto as Appendix A what it believes to be a minimum budget for effective participation by the State in the FERC proceedings. The budget contemplates total legal and consultant fees of \$2,662,900 spread over three fiscal years.^{13/} For each fiscal year, the expenses are divided by consultants and the two law firms. The contemplated fees and expenses of the law firms are further subdivided by the nature of the expenditure.

While an expenditure of \$2.6 million seems high, it will be dwarfed by the amounts spent by the eight TAPS owners in defense of their filed rates. It is also small in comparison with the billions of dollars which are at stake to the State in the proceeding. Viewed another way, the State will recoup its expenses in one year if FERC lowers the filed tariffs by only three cents per barrel from the proposed tariffs in excess of \$6.00. In this regard, it should be noted that the law firms and the consultants will be compensated in accordance with hourly fees which the Department negotiates with them, not on a contingent fee basis. Therefore, our expenses will not be subject to upward revision in the event that the State's challenges to the TAPS tariff are sustained.

In sum, the Department recommends that the State continue to participate in the FERC proceedings to investigate

^{13/} This budget was prepared using 1977 dollars so that projected expenditures for the second and third fiscal years would have to be adjusted upward to account for inflation.

the TAPS tariffs and believes that its proposed budget represents the minimum expenditure necessary for effective participation on the State's behalf.

APPENDIX A

TOTAL OVER 3 FISCAL YEARS \$2,662,900

1. Fiscal Year ending 6/30/78

Total: First Fiscal Year \$1,352,500

Phase I (assumes this phase continues through briefing stage in this fiscal year)

Engineering Consultant \$ 25,000

Other Consultants 230,000

Wald, Harkrader & Ross ("WH&R"):

Lawyers 297,500

Legal Assistants 36,000

Expenses 5,000

Donelan, Cleary, Wood & Maser ("DCW&M"):

Lawyers 221,000

Legal Assistants 36,000

Other Expenses 15,000

Transcript 8,000

Phase II (assumes this phase moves forward actively into discovery and substantial prehearing analysis this fiscal year)

Consultants \$ 100,000

WH&R:

Lawyers 238,000

Legal Assistants 54,000

Expenses 10,000

Donelan & Cleary:

Lawyers	\$ 58,500
Legal Assistants.	15,000
Expenses.	3,500

2. Fiscal Year ending 6/30/79

Total: Second Fiscal Year. \$1,042,400

Phase II

Consultants \$ 300,000

WH&R:

Lawyers	374,000
Legal Assistants.	60,000
Expenses.	5,000

DCW&M:

Lawyers	234,000
Legal Assistants.	36,000
Other Expenses.	20,000
Transcripts	13,400

3. Fiscal Year ending 6/30/80

Total: Third Fiscal Year \$ 268,000

Phase II

Consultants \$ 30,000

Law

FY 77

SLA 76 · Ch 89

ICC Representation	165.0
ICC Investigation Analysis	300.0

FY 78

Contractual Services (Budget Bill)	185.0
sub-total	<u>650.0</u>

Pipeline Commission

FY 77

SLA 77 Ch 5

TAPS Investigation	843.7
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FY 78

Budget Bill	293.0
sub-total	<u>1,136.7</u>

total 1,786.7

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

WH&R:

Lawyers	\$ 144,500
Legal Assistants.	6,000
Expenses.	2,000

DCW&M:

Lawyers	78,000
Expenses.	7,500

Assumptions:

(1) Transcript costs and major document duplicating and printing costs payable out of Donelan & Cleary budget.

(2) Consultants' expenses payable out of consultants' budget.

(3) Expenses do not reflect use of computer systems.

(4) The hours projected in both phases assume only one level of briefing before FERC, and do not cover court proceedings.

(5) Second and third fiscal year budgets are estimates, in 1977 dollars, and are not adjusted for inflationary cost increases.

FY 77

Law

SLA 76 Ch 89

ICC Representation 165.0

ICC Investigation Analysis 300.0

FY 78

Contractual Services (Budget Bill) 185.0

sub-total 650.0

Pipeline Commission

FY 77

SLA 77 Ch 5

TAPS Investigation 843.7

FY 78

Budget Bill 293.0

sub-total 1,136.7

total

1,786.7

Original sponsor: Rules Committee by
request of the Governor

Offered: 2/24/77
Referred: Rules

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2 CS FOR HOUSE BILL NO. 122

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act making a supplemental appropriation to the
7 Alaska Pipeline Commission; and providing for an
8 effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. The sum of \$843,700 is appropriated from the general fund to
11 the Alaska Pipeline Commission, for fiscal year 1977, for the purpose of
12 investigating the cost of the trans-Alaska pipeline system and to undertake
13 an economic analysis fundamental to the setting of tariffs.

14 * Sec. 2. This Act takes effect immediately in accordance with AS 01.10.-
15 070(c).

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Introduced: 1/26/77
Referred: Finance

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE BILL NO. 122

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act making a supplemental appropriation to the
7 Alaska Pipeline Commission; and providing for an
8 effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. The sum of \$500,000 is appropriated from the general fund
11 to the Alaska Pipeline Commission, for Fiscal Year 1977, for the purpose of
12 investigating the cost of the Trans Alaska Pipeline System and to undertake
13 an economic analysis fundamental to the setting of tariffs.

14 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
15 10.070(c).

7 Analysis of Governor's Decisions

ITEM & EXPLANATION	AMOUNT	FUNDING SOURCE	100 PERSONAL SERVICES	200 TRAVEL	300 CONTR. SERVICES	400 COMM.	500 EQUIPMENT	OTHER
Agency Request FY 78	789.7	GF	430.5	31.3	318.4	3.5	6.0	
Disallow 5 new change positions	(194.0)	GF	(178.2)	(3.9)	(6.2)	(1.0)	(4.7)	
Reduce managerial audits to original request	(15.6)	GF			(15.6)			
Disallow request for economic analyses	(200.0)	GF			(200.0)			
Allow funding for professional services in lieu of establishing new positions	200.0	GF			200.0			
Additional merit increase funding 528 x 1.255 439 x 1.255	(1.2)	GF	(1.2)					
Recommendation	578.9	GF	251.1	27.4	296.6	2.5	1.3	
<i>FY 78 FCC Budget approved as above.</i>								

BRU Alaska Pipeline Commission BRU CODE 08-53-4-06-00-00. REVISED 11/12/76

6 Analysis of Change

ITEM & EXPLANATION	AMOUNT	FUNDING SOURCE	100 PERSONAL SERVICES	200 TRAVEL	300 CONTR. SERVICES	400 COMM.	500 EQUIPMENT	OTHER
<p>In-house engineering analyses, economic feasibility studies and financial reviews of carrier applications for Certificates of Public Convenience and Necessity and tariff filings. This change would require two engineers, an additional auditor, an executive director, a research analyst and a secretary. A management review and financial audit of Alyeska Pipeline Service Company would require primary support by an independant consultant.</p>		GF	223.7	18.7	253.0	1.5	5.7	
<p>Total FY-78 Change</p>	502.6	GF	223.7	18.7	253.0	1.5	5.7	

BRU ALASKA PIPELINE COMMISSION BRU CODE 08-53-4-06-00-00 REVISED 11/12/76

5 Analysis of Maintenance Level

ITEM & EXPLANATION	AMOUNT	FUNDING SOURCE	100 PERSONAL SERVICES	200 TRAVEL	300 CONTR. SERVICES	400 COMM.	500 EQUIPMENT	OTHER
OO-Pipeline Commission								
FY-77 Authorized	330.4	GF	218.3	8.5	101.6	2.0		
FY-78 Merit and benefit increases	10.5	GF	10.5					
Commission Salary Reduction	(22.0)		(22.0)					
Travel increases for full Commission	3.4	GF		3.4				
Contractual Services decrease due to addition of staff	(39.9)	GF			(39.9)			
Commodities decrease due to better estimates	(.2)					(.2)		
Equipment increase due to staff addition	.3	GF					.3	
Sub-Total	282.5	GF	206.8	11.9	61.7	1.8	.3	
Inflation - 6%	4.6	GF		.7	3.7	.2	.0	
FY-78 Maintenance Total	287.1	GF	206.8	12.6	65.4	2.0	.3	

218.3
154.1
-34.2

5 Analysis of Maintenance Level

ITEM & EXPLANATION	AMOUNT	FUNDING SOURCE	100 PERSONAL SERVICES	200 TRAVEL	300 CONTR. SERVICES	400 COMM.	500 EQUIPMENT	OTHER
Commerce Attorney IV, Anchorage	45.9	IA	45.9					
Human Rights Commission Legal Secretary I, Perm. P/T	8.4	IA	8.4					
Maintenance - Work Load Increase Legal Secretary I, Anchorage	21.4	GF	16.9		2.8	.5	1.2	
Attorney IV, Anchorage	48.6	GF	44.3	1.5	1.0	.5	1.3	
Subtotal	3771.7	2426.1 GF 1345.6 IA	3015.7	93.2	591.3	38.5	9.4	23.6
Rents & Utilities - Space Projections for Anchorage Office	14.0	GF			14.0			
Ch 201, SLA 1976, ICC Representation	200.0	GF		15.0	185.0			
Inflation 6%	42.2	27.7 GF 14.2 IA		4.8	34.9	2.5		
Less FY 77 Equipment	(2.2)	(1.6) GF (.6) IA					(2.2)	
FY 78 Maintenance Level	4025.7	2666.5 GF 1359.2 IA	3015.7	113.0	825.2	41.0	7.2	23.6
<p><i>FCC * FY 78 Budget approved as above with only minimal general reductions in all line items -- 21.0 reduction in contractual</i></p>								

BRU Legal Services

BRU CODE 03-94-1-01-00-00 REVISED 10-19-76

CATEGORY: GENERAL GOVERNMENT
 AGENCY: DEPARTMENT OF LAW

PROGRAM: LEGAL SERVICES
 SUB-PROGRAM:

EXPENDITURES & FUNDING	(01) FY76 ACT	(02) FY77 ATH	(03) FY77 YTD	(04) FY77 RP	(05) FY77 SUP	(06) MAINT	(07) REQUEST	(08) GOVERNOR	(09) HOUSE	(10) SENATE	(11) F.C.C.	(12) BILLS	(13) LEG. REC.
01 PERS. SERV.	2242.0	2432.4	100.0%	134.2		3015.7	3015.7	2973.6	2929.4	2918.6	2929.4	64.5	
02 TRAVEL	75.4	80.0	100.0%		10.0	113.0	113.0	113.0	111.5	113.0	111.5	6.5	
03 CONTRACTUAL	394.7	582.7	100.0%		515.0	825.2	825.2	825.2	804.2	825.2	804.2	74.3	
04 COMMODITIES	34.8	36.0	100.0%	.3		41.0	41.0	41.0	40.5	41.0	40.5	3.9	
05 EQUIPMENT	9.9	6.9	100.0%			7.2	7.2	7.2	5.9	7.2	5.9	4.0	
06 LANDS/BLDGS		8.6	100.0%			8.6	8.6	0.6	8.6	8.6	8.6		
07 GRANTS, CLMS	58.1	15.0	100.0%			15.0	15.0	15.0	15.0	15.0	15.0		
08 MISC.				20.0	279.9					-130.0			
** TOTAL EXPEND	2814.9	3161.6	100.0%	154.5	804.9	4025.7	4025.7	3983.6	3915.1	3798.6	3915.1	153.2	
09 I-A TRANSFER	7.4					16.5	16.5	16.5	16.5	16.5	16.5		
10 FED. RECEIPT													
11 G. F. MATCH													
12 GENERAL FUND	1940.3	2071.1		20.0	804.9	2666.5	2666.5	2639.6	2571.1	2454.6	2571.1	153.2	
13 PGM RECEIPTS													
14 OTHER FUNDS	874.6	1090.5		134.5		1359.2	1359.2	1344.0	1344.0	1344.0	1344.0		
15 FULL-TIME	70.0	76.0		4.0		83.0	83.0	83.0	82.0	82.0	83.0		
16 PART-TIME	1.0	1.0		1.0		2.0	2.0	2.0	2.0	2.0	2.0		
17 TEMPORARY	.3	.4				.4	.4	.4	.4	.4	.4		
18 MAN-MONTHS	851.0	922.0				1012.0	1012.0	1012.0	1000.0	1000.0	1012.0		

NEW POSITIONS

TITLE	LOCATION	TYPE	REQ	S&B COST	OTH. COST	TOT. COST	FED. FUND	GEN. FUND	OTH. FUND	GV	HS	SN	FC	FN
1 ATTORNEY IV	FAIRBANKS	FULL	1	53.2	1.5	54.7			54.7	1	1	1	1	
2 LEGAL SECRETARY I	FAIRBANKS	FULL	1	19.1	3.3	22.4			22.4	1	1	1	1	
3 ATTORNEY II	ANCHORAGE	FULL	1	31.8	1.5	33.3			33.3	1	1	1	1	
4 ATTORNEY II	JUNEAU	FULL	1	31.8	11.7	43.5			43.5	1	1	1	1	
5 ATTORNEY IV	ANCHORAGE	FULL	1	45.9		45.9			45.9	1	1	1	1	
6 LEGAL SECRETARY I	ANCHORAGE	PART	1	8.4		8.4			8.4	1	1	1	1	
7 LEGAL SECRETARY I	ANCHORAGE	FULL	1	16.9	4.5	21.4		21.4		1	1	1	1	
8 ATTORNEY IV	ANCHORAGE	FULL	1	44.2	4.3	48.5		48.5		1	1	1	1	
** NEW POSITION TOTALS			8	251.3	26.8	278.1		69.9	208.2	8	7	8	8	

REVISED PROGRAMS, SUPPLEMENTAL & SPECIAL APPROPRIATIONS AND FISCAL NOTES...

REVISED PROGRAMS: 77-200 \$20.0, 77-93 \$88.4, 77-131 \$40.0, 77-158 \$6.1.

SUPPL. APPROPRIATIONS: HB 167 \$804.9.

FISCAL NOTES: HB 399 \$153.2

*Gov. Vetted
 Special Utility
 Consumer Council*

*Ch. 89 ICC Representation 165.0
 ICC Investigation Analysis 300.0
 Gas Pipeline 60.0
 Judgments Against the State 279.9*

DEPARTMENT OF LAW
OFFICE OF THE ATTORNEY GENERAL
ANCHORAGE BRANCH
260 "K" ST., SUITE 105
ANCHORAGE, ALASKA 99501
PHONE: 272-1522

1 3. Notice. Any notice required to be made in
2 writing under the terms of this contract will be deemed to
3 be sufficient notice if it is a written notice transmitted
4 to the other party by certified mail addressed to the
5 residence or principal place of business of the party.

6 4. (a) Duties. Terry F. Lenzner, the special
7 counsel for the Alaska Pipeline Commission, will investigate
8 the costs and charges incurred by the Alyeska Pipeline
9 Service Company during the construction of the Trans-
10 Alaska Pipeline, employing such powers of the Pipeline
11 Commission established by statute and delegated to him by
12 the Alaska Pipeline Commission. The investigation will
13 commence with an analysis of the goals and possible
14 accomplishments of the investigations currently being
15 conducted by the Interstate Commerce Commission and the
16 General Accounting Office and an analysis of the data
17 supplied to the Commission by Alyeska Pipeline Company
18 obtained from other sources.

19 (b) Reports. Terry F. Lenzner,
20 special counsel, will, by May 1, 1977, prepare and
21 transmit to the Alaska Pipeline Commission (1) a report
22 which shall contain an analysis of the investigations
23 conducted by the General Accounting Office and the Interstate
24 Commerce Commission; (2) an analysis of those costs which
25 will not be extensively investigated by the two aforementioned
26 agencies; (3) a list of those areas which, in the opinion
27 of the special counsel, should be explored in greater
28 depth by the Alaska Pipeline Commission; (4) a proposed
29 plan of investigation which shall include an estimate
30 of the time, manpower and financial resources necessary
31 to complete the proposed plan of investigation.

32 (c) Obligations To The Commission. During
33 the course of his employment as special counsel,
34 Terry F. Lenzner agrees to devote a period of time

to the fulfillment of the aforementioned duties to complete his investigation within the contract period set forth herein.

1 5. Interim Reports. Terry F. Lenzner, while acting as
2 special counsel, shall maintain a daily time report showing the
3 number of hours spent on Pipeline Commission business and the
4 nature of that business. This report will be made available for
5 the inspection of the Pipeline Commission upon request. A report
6 will be transmitted to the Alaska Pipeline Commission on a monthly
7 basis showing in aggregate the hours expended on Commission
8 business. In addition, Terry F. Lenzner, special counsel, will,
9 together with the monthly time report to the Alaska Pipeline
10 Commission, and his monthly bill, submit an itemized record of
11 expenses incurred during the course of the month and a brief
12 narrative description of the activities done in that month.

13 6. Terry F. Lenzner, special counsel, will receive
14 \$150,000 for the reports required to be prepared for the Commis-
15 sion pursuant to the provisions of paragraph 4(b) of this agree-
16 ment. Twenty-five thousand dollars will be paid immediately after
17 the signing of this agreement. Twenty-five thousand dollars will
18 be paid on January 1, 1977, \$50,000 will be paid on February 1,
19 1977, and the final \$50,000 will be paid at the satisfactory
20 conclusion of the contract. If the contract is terminated for
21 any reason whatsoever before it is completely paid, work done
22 during a period for which the special counsel has not previously
23 been paid will be compensated on an hourly basis. Special
24 counsel will maintain records of the time expended by him or
25 those of his employ upon which such a determination can be reached.

26 7. Employees of the Special Counsel. Special counsel
27 shall notify the Commission when he employs other individuals,
28 professional or clerical, for the purpose of assisting him with
29 the investigation.

30 8. Relations Between the Parties. For the
31 purposes of this agreement, Terry F. Lenzner, special
32 counsel, will be considered as a member of the staff of

ATTORNEY GENERAL, STATE OF ALASKA
STATE CAPITOL
POUCH K, JUNEAU, ALASKA 99811
PHONE 462-5500

1 the Alaska Pipeline Commission. The report and preliminary
2 drafts of such reports prepared by Terry F. Lenzner, during
3 the course of his investigation, whether prepared by him
4 or any individual employed by him pursuant to the terms
5 of this contract, shall be considered to be the property
6 of the Alaska Pipeline Commission and shall be given to
7 the Commission upon the request of the Commission or at the
8 conclusion of this agreement.

9 9. Nondisclosure of Information. Terry F. Lenzner,
10 special counsel, agrees not to disclose nor to permit any
11 individual employed by him, pursuant to the terms of this
12 agreement, to disclose information obtained during the
13 course of the investigation without the express permission
14 of the Alaska Pipeline Commission except that the special
15 counsel may utilize information obtained during the
16 investigation in further inquiries.

17 10. Liability. Terry F. Lenzner, special
18 counsel, agrees to hold the State harmless for any
19 liability incurred by him or by any individual employed by
20 him during the life of this agreement pursuant to the
21 provisions of this agreement: including but not limited
22 to, liability for personal injuries, libel, and improper
23 disclosure of trade secrets or confidential information.

24 11. Remedy for Breach. In the event of a breach
25 of this contract, the parties may file suits in a
26 Superior Court within the State of Alaska for damages or
27 specific performance. Nothing contained in this agreement
28 shall be construed as a waiver of the sovereign immunity of
29 the State of Alaska from being sued in the courts of the
30 United States or of other states. Any disputes between
31 the parties shall be settled with reference to Alaska law.

32 12. Entire Agreement. This agreement is the
33 entire agreement between the parties. There are no
34 unintegrated oral agreements. This agreement may not be
changed *except in writing by agreement of the parties*

DEPARTMENT OF LAW
OFFICE OF THE ATTORNEY GENERAL
ANCHORAGE BRANCH
300 "H" ST., SUITE 105
ANCHORAGE, ALASKA 99501
PHONE: 272-1822

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13. Arbitration. Any disputes arising between the parties shall be submitted to arbitration in the Municipality of Anchorage. The method of selecting an arbitrator shall be as follows: each party shall select an arbitrator and the first two arbitrators shall select a third arbitrator to whom the dispute will be referred.

14. Nondiscrimination. Terry F. Lenzner, special counsel, agrees that during the course of employment with the Commission, he will comply with all applicable federal and state laws prohibiting discrimination.

DATED this 22nd day of November, 1976.

ALASKA PIPELINE COMMISSION

By: *Harry J. Donahue*
Harry J. Donahue, Chairman

DATED this 24th day of November, 1976.

Terry F. Lenzner
Terry F. Lenzner
Special Counsel

DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

By: *L.A. Kotley*
Langhorne A. Kotley, Commissioner
Date: 12/27/76

DEPARTMENT OF ADMINISTRATION

By: *Richard B. Smith*
12.27.76

DEPARTMENT OF LAW
OFFICE OF THE ATTORNEY GENERAL
ANCHORAGE BRANCH
363 "K" ST., SUITE 105
ANCHORAGE, ALASKA 99501
PHONE: 272-1522

1 AMENDMENT ONE TO THE AGREEMENT BETWEEN
2 THE ALASKA PIPELINE COMMISSION AND TERRY F. LENZNER

3 Paragraph 6 of the agreement is amended to
4 read as follows:

5 Terry F. Lenzner, special counsel, will receive
6 \$150,000 for the reports required to be prepared for the
7 Commission pursuant to the provisions of paragraph 4(b) of
8 this agreement. Twenty-five thousand dollars will be
9 paid immediately after the signing of this agreement.
10 Twenty-five thousand dollars will be paid on January 1, 1977,
11 \$50,000 will be paid on February 1, 1977, and the final
12 \$50,000 will be paid at the satisfactory conclusion of the
13 contract. If the contract is terminated for any reason
14 whatsoever before it is completely paid, work done during
15 a period for which the special counsel has not previously
16 been paid will be compensated on an hourly basis. Special
17 counsel will maintain records of the time expended by him
18 or those of his employ upon which such a determination
19 can be reached.

20 DATED at Anchorage, Alaska, this 22nd day
21 of December, 1976.

22 ALASKA PIPELINE COMMISSION

23 By Harry J. Donahue
24 Chairman

25 DEPARTMENT OF LAW
26 OFFICE OF THE ATTORNEY GENERAL
27 ANCHORAGE BRANCH
28 300 "K" ST., SUITE 105
29 ANCHORAGE, ALASKA 99501
30 PHONE: 272-1522
31
32
33
34

JAY, S. HAMMOND
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 16, 1977

The Honorable Steve Cowper
House Finance Committee
Pouch V
Juneau, Alaska 99811

Dear Representative Cowper:

In light of the importance of an accurate determination of the actual and reasonable costs of construction of the trans-Alaska Pipeline (TAPS), I request that HB122 "An Act making a supplemental appropriation to the Alaska Pipeline Commission; and providing for an effective date", be amended to an appropriation of \$843,700 in general funds in place of the present \$500,000. Under AS 42.06, the Alaska Pipeline Commission is the appropriate agency to conduct this investigation. The Pipeline Commission has already entered into a contract with Mr. Terry Lenzner for investigation of TAPS under the authority of Revised Program 77-217 as endorsed by the Legislative Budget and Audit Committee. A supplemental appropriation for an additional contract is now needed to continue these efforts.

Mr. Lenzner's investigation will be a detailed and indepth study of the costs and management practices of Alyeska in constructing the trans-Alaska Pipeline. An investigation of this magnitude requires expertise in numerous areas as well as a large amount of time in collecting and analyzing the documents generated by the construction. Mr. Lenzner has agreed to head the investigation, including hiring, organizing, directing, and paying for the activities of the investigative staff, for an amount not to exceed \$806,000. Of this amount, \$645,700 still must be appropriated, and is included in the requested change. Although it is hoped that the investigation will be completed by July 1, 1977, the contract with Mr. Lenzner will probably state an ending date of September 1, 1977, to allow for unexpected developments.

Mr. Lenzner's report will not analyze the data for purposes of the Pipeline Commission's intrastate rate-making activities.

The Honorable Steve Cowper -2-

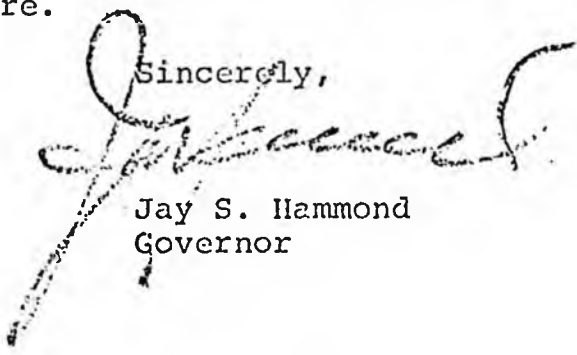
February 16, 1977

This analysis will be provided by Dr. Michael J. Ileo of Technical Associates, Inc., a Washington, D.C. based economic consulting firm. The cost of Dr. Ileo's activities is \$166,000, which sum is included in the requested supplemental appropriation.

Finally the Commission has requested \$21,000 for the hiring of a CPA auditor and engineer for its staff, for the period of April 1, 1977 through June 30, 1977, which amount is also included in the supplemental appropriation.

The Department of Commerce and the Alaska Pipeline Commission as well as the Department of Law are able to provide further verbal and written information regarding the supplemental should you so desire.

Sincerely,



Jay S. Hammond
Governor

**The Management, Planning and Construction
of the Trans-Alaska Pipeline System**

**REPORT TO THE ALASKA PIPELINE COMMISSION BY THE
COMMISSION'S SPECIAL COUNSEL, TERRY F. LENZNER**

Terry F. Lenzner
Wald, Harkrader & Ross
1320 Nineteenth Street, N.W.
Washington, D.C. 20036

August 1, 1977

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- CHAPTER V -- Productivity and Labor Management

- CHAPTER VI -- Camps, Catering and Communications

- CHAPTER VII -- Engineering Management

- CHAPTER VIII -- Quality Control

- CHAPTER IX -- Design and Installation of Vertical Support Members

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- * CHAPTER XII -- Conclusions and Recommendations

Appendix A: The Special Counsel's Investigation

*Due to the size of the report, only the two introductory chapters and the Conclusions and Recommendations were reproduced for distribution by Legislative Finance.

EXECUTIVE SUMMARY

It is the purpose of the Special Counsel's Report to analyze the planning and construction of the Trans-Alaska Pipeline System (TAPS), and, in cooperation with consulting experts, to identify those expenditures, if any, which were imprudently incurred. The evidence summarized in the eleven chapters which comprise the Report form the basis of the Special Counsel's conclusion that, of the \$8 billion spent to construct the TAPS, \$1.5 billion represents excessive expenditures -- principally as a result of mismanagement and indifference to project costs.

Chapter II of the Report reviews the various incarnations through which the TAPS management structure passed between the discovery of oil on the North Slope and completion of the pipeline. These developments are divisible into three time periods: the pre-construction period (1968-1973); the period during which Bechtel Incorporated (Bechtel) served as Construction Management Contractor (1973-1975); and the period following Bechtel's termination (1975-1977).

Because legal challenges delayed the start of the TAPS construction for over three years, the pre-construction period provided the TAPS owner companies with a unique opportunity to remedy several basic organizational and managerial deficiencies identified as early as 1970. The owners failed to take advantage of this opportunity. Although they created

the Alyeska Pipeline Service Company (Alyeska) to plan and construct the pipeline, Alyeska's officers recognized they lacked necessary planning and construction management expertise. Thus, by 1972, Alyeska management was imploring the TAPS owners to contract with Bechtel for planning and construction management.

The TAPS owners refused to heed Alyeska's pleas. Rather, after considerable time had passed, they commissioned another firm to engage in a much more limited planning effort. It was not until late 1973 -- with construction scheduled to start within four months -- that Bechtel was brought onto the project and a semblance of effective, albeit belated, planning began. According to Peter DeMay, an Alyeska Vice President, the TAPS owners' decision to delay adequate pipeline planning was motivated by political considerations, i.e. they did not want to appear overly committed to the project at a time when Congress was considering what environmental constraints should accompany its authorization of the project.

The results of such political "gaming" proved disastrous for the project. As discussed in Chapters II through IV of the Report, construction began without effective internal cost control systems, procurement and inventory procedures, or labor management mechanisms in place. The absence of adequate planning was exacerbated by a duplicative four-tiered management structure established by the owner companies (owners committee;

Alyeska; construction manager -- Bechtel for the pipeline; and the Execution Contractors). Lines of management authority were confused; a "pass the buck" attitude prevailed and all concerned -- from Bechtel to the labor unions -- were left distrusting and frustrated.

The TAPS owner companies' solution was to terminate Bechtel as construction manager in May, 1975. Alyeska -- without adequate experience or staffing to manage the project -- thus replaced Bechtel in the midst of the second construction year. The reorganization did not improve the situation, however, and in 1976, pipeline productivity showed a significant decline. The result was to extend pipeline construction through the expensive winter season into 1977.

As Chapter III examines, one of the major failings of Alyeska and its Construction Management Contractors (CMCs) on the TAPS project was their inability to establish a project cost estimate and related control systems prior to major commitments and expenditures. Indeed, the estimate was not in a form deemed acceptable by the owners until May, 1975, mid-way through the second construction year. This failure occurred in spite of the fact that both the owners and Alyeska recognized that project cost control could not "be achieved without an appropriate cost baseline."

Because it provides project management a standard by which to measure performance, the estimate is crucial to

an early identification of problems and the implementation of corrective action. Moreover, it was prerequisite to the establishment of effective incentive plans -- plans contingent upon a target cost and schedule. Alyeska's inability to prepare the cost estimate precluded the development of a viable contractors incentive program. The result was that the incentive plans were instituted late, administered poorly and terminated prematurely. Thus, the TAPS owners had no method, and the contractors had no motive to control costs.

Finally, the TAPS owners and Alyeska failed to establish sound internal controls prior to full-scale construction. This situation developed despite the fact that the owner companies' and Alyeska's auditors repeatedly emphasized the need for project controls. In sum, a combination of inadequate owner support and Alyeska's own ineptitude led the company into the most expensive privately-financed project in United States history without sound internal controls in place.

Likewise, as Chapter IV describes, the TAPS management was unable to develop systems and procedures to assure that construction equipment, material and spare parts were purchased, delivered and inventoried in a cost-effective manner. The result was an often-chaotic situation. Execution Contractors desperately sought to requisition spare parts which (unbeknownst to them) were already located in their own warehouses. Because of inadequate warehouse space,

equipment and material were often stored outside and effectively lost after the first snowfall. By the time the spring thaw came, much material had either been ruined by the weather or stolen.

These problems interacted with inadequate procurement procedures to create costly delays and other expensive impacts. In December, 1976, Alyeska's internal auditors reported that many purchasers of the TAPS supplies had been "really ripped off" because they "accepted the price without any thought as to the reasonableness of that price."

The genesis of this situation was Alyeska's failure to have procurement and inventory control systems and procedures in place when construction began. Alyeska lacked experience in this area and looked for assistance from its Construction Management Contractor. However, as noted, the TAPS owners did not bring on Bechtel as Construction Management Contractor until late 1973. As a result, construction began with little or no procurement or inventory control systems and, as late as 1975, the project was still struggling to convert from manual to computerized systems.

Another reason for the project's problems in this area appear attitudinal. The most graphic illustration concerns the lack of procurement planning which led to the purchase of three types of pipeline tape before a satisfactory product was found. Evidence of lack of cost consciousness

was clear in Alyeska's decision to spend millions of dollars to purchase tape which it later tested and found to be inappropriate for the job. Not learning from this experience, Alyeska spent millions of additional project dollars on a tape that likewise proved inadequate, thus requiring the purchase of a third type of tape.

An even more damning aspect of this episode was the approach of a TAPS owner company representative when problems with the second tape first came to light. After reporting the problems with the second tape (Royston tape) to Alyeska's Senior Project Manager, ARCO's Lloyd C. Foy added:

It might be well to destroy this report so there will be nothing in your files that indicate any expected trouble with Royston tape.

In Chapter V, the causes of low project productivity and labor mismanagement are examined. Mismanagement of the project resulted in pipeline productivity that was only 57% of what Alyeska itself estimated it should have been. Moreover, productivity declined significantly as the project progressed. The result was excess expenditures of nearly \$1.3 billion on the pipeline portion of the project alone.

Alyeska's poor labor management was a major contributor to the excesses. Alyeska ineptly handled union management relations. In addition, Alyeska and its contractors failed early in the project to establish adequate craft screening

procedures and neglected to implement adequate foreman training programs to familiarize these important work supervisors with the rules and conditions of the TAPS construction. These failures led to unacceptable workmanship and needless delays.

One of the most serious -- and best publicized -- of Alyeska's labor problems was that of workers frequently idle at the job site (including sleeping on buses and sunbathing along the right-of-way). Alyeska's own documents show that the principal responsibility for idleness rested with management's poor supervision and utilization of the work force. Most of the workers were willing to work, but lacked "adequate direction and support" from a disorganized project management.

In addition to poor supervision and utilization of labor, Alyeska failed to implement adequate systems and policies to ensure control over man-hour expenditures. Alyeska only belatedly established adequate records to measure and monitor productivity and man-hours. Moreover, Alyeska failed to take corrective action, which these records showed to be necessary. Thus, such situations as the non-enforcement of essential work rules, payment for grossly excessive overtime, and rampant time card abuse (including a number of workers who got paid for successive twenty-four hour days) went largely uncontrolled through the life of the project. Our analysis

indicates that, based on Alyeska's own field reports, the cost of time wasted through such inadequate man-hour control amounted to at least \$466 million.

Chapter VI discussed the project's failures to provide the work force with sufficient labor camp facilities, a cost-effective food catering service, or an adequate communications system. The story is a familiar one: as a result of belated planning, the TAPS construction began without adequate housing, catering control, or communications facilities in place. The result was that not only did expenditures for these vital support functions far exceed expectations, but the housing and communications problems delayed construction progress. They also caused numerous adverse "ripple" impacts.

Another significant problem was project engineering, as discussed in Chapter VII. In both pre-construction design work and in engineering support to the Execution Contractors in the field, Alyeska failed to adequately fulfill its obligations as Engineer.

In particular, the early design work on the pump stations and terminal, which Alyeska passed on to Fluor for completion, proved virtually unusable. So much design and change-order work was involved in Fluor's belated effort to correct Alyeska drawings that, by Alyeska Vice-President Peter DeMay's own admission, the cost of this "bust" was between \$50 million and \$100 million.

Alyeska also experienced serious problems with pipeline engineering, for which it retained full responsibility throughout the project. Originally scheduled to be completed in January, 1974, the general design was not finished until 1975. Alyeska claimed that the delay in initiation of construction from 1974 to 1975 was caused primarily by overly stringent governmental approval requirements. It appears that most of the delay was, in fact, largely a result of Alyeska's own failure to complete designs promptly for governmental approval.

The effects of incomplete design extended well beyond the start-up of construction. Indeed, the Execution Contractors complained of insufficient engineering support all the way through the 1976 construction season. The evidence shows that the contractors faced a particularly consistent problem in obtaining adequate construction drawings promptly from Alyeska. In addition, due to a lack of engineering authority in the field and a cumbersome bureaucracy in the home office, Alyeska failed to ensure the timely resolution of engineering problems encountered during construction. The results of these deficiencies included: numerous and costly delays as men and equipment awaited overdue engineering decisions, problems with efficient work rescheduling as contractors tried to build around those areas for which they lacked sufficient engineering; and in some instances, work that had to be redone because of inadequate

engineering information.

Chapter VIII describes the TAPS project's failure to develop and implement effective quality control and quality assurance programs. From the outset, the quality control and quality assurance programs proved inadequate. Early in 1975, at a government Weekly Coordination Meeting, concern was raised by representatives from the Department of Interior's Alaska Pipeline Office, regarding Bechtel's poor quality control performance. In July, 1975, Peter DeMay, Alyeska Vice-President, complained that he continued to receive reports about inadequate, and, in some cases, non-existent, quality control activities in the field.

The most dramatic example of costly and persistent quality control and quality assurance problems related to welding, where remedial work cost the project at least \$80 million. One of the most serious welding problems experienced in all pipeline sections was the unreasonably high weld reject rate, which averaged 30% and reached as high as 80%. The slow pace of x-ray crews, which lagged several miles behind welding crews, perpetuated faulty welding techniques and production of welds suspected of having a high percentage of defects. As early as May, 1975, owner company representatives observed firsthand the poor x-ray productivity and inefficient quality control which led to a high percentage of weld rejects.

In view of the serious deficiencies which pervaded the TAPS welding and radiography program, Alyeska began an audit of radiographs for the entire pipeline. This audit identified 3,955 "irregular" welds, 1,015 of which were "critical", e.g. already buried under rivers. At the same time, it came to light that radiographers at the double-joint yard at Fairbanks had participated in a scheme developed by Bechtel's quality control to falsify numerous x-rays.

The failure of the project's quality control program to perform adequately not only contributed to the high weld reject rate, but also caused numerous construction delays. As a consequence, welding costs soared far beyond budget control estimates: large numbers of man-hours were spent on weld repair and re-x-ray while millions of dollars worth of equipment was purchased to implement the work. A conservative estimate is that the mismanagement of the welding and radiography programs resulted in excess expenditures of \$80 million.

Chapter IX of the report discusses the problems which resulted in those portions of the pipeline constructed above-ground. The aboveground mode required the mainline pipe to be supported on a crossbeam installed between two vertical support members (VSMS) embedded in the ground. The vertical support member construction operation suffered from a profusion of difficulties, and present in each was the common denominator of mismanagement and inadequate supervision.

Problems with vertical support members were among the worst the contractors encountered, in large part, as a result of insufficient testing and the ongoing redesign effort. Federal government agencies found Alyeska's vertical support member design criteria inadequate because of insufficient confirmation by actual field tests. Consequently, Alyeska had completed installation of more than half of all VSMS before the government-required test report was issued.

Further, many costly delays were incurred because the unavailability of that vertical support member equipment, for which Alyeska was responsible, seriously hampered the Execution Contractors' efforts to install vertical support members according to schedule. For example, Bechtel reported in June, 1975, that of thirteen drills Section 5 was supposed to be using, six had not yet arrived and three drills on site were not operational. Delivery delays and equipment failures were compounded by the lack of adequate supply of vertical support member spare parts. For several months during the 1975 construction season, lack of vital vertical support member parts resulted in the use of stop-gap measures rather than the proper repair of equipment. Alyeska's President, E. L. Patton, admitted that, "We went into the project with some spares in VSM and aboveground hardware, but it certainly wasn't the number of spares we ultimately needed."

Serious splitting and cracking problems also undermined vertical support member installation efforts. Part of the problem was traced to the vertical support member pipe itself, which was not holding up under corrugation. According to the results of an Alyeska inquiry, corrugation specifications had been written before the physical limitations of the corrugating machine had been established. The result of such poor planning problems was that, in Alyeska's words, vertical support member installation was a "start-and-stop" operation.

The most obvious impact of VSM delays and mismanagement was upon labor costs. The same labor management deficiencies which plagued the project generally, characterized the vertical support member installation effort. Our analyses reveal that \$112 million was wasted to remedy vertical support member problems which were, to a large extent, unnecessary and avoidable.

Chapter X contains a case history of "Section 5" -- the most mismanaged portion of the pipeline project. The magnitude of Section 5's problems is highlighted by studies prepared by the Aerospace Corporation, our engineering consultants. Their study shows that construction conditions in Section 5 were not more difficult than elsewhere on the project. Thus, the massive cost overruns which Arctic experienced cannot be attributed to Section 5's terrain or climate. Rather, the project was plagued by crucial management deficiencies which

were belatedly identified and never solved. Aerospace has concluded that Section 5 incurred excess costs of at least \$176.4 million.

Finally, Chapter XI examines the efforts of Alyeska and its contractor, Fluor, to design and construct the Valdez terminal and pump stations portion of the TAPS project. As a result of inadequate geotechnical planning, the terminal site preparation at Valdez escalated in cost to nearly ten times its original estimate. Further, as noted above, Alyeska's engineering design work for pump stations and terminal proved useless to the project - resulting in what one Alyeska officer termed a \$50 to \$100 million "bust."

Once underway, terminal construction was plagued by the same problems as the pipeline: poor management supervision and coordination, inadequate inventory and cost control systems, etc. As a result, the several billion dollars expended for the terminal and pump stations portion of the TAPS project was excessive by many millions of dollars.

In sum, drawing upon the evidence gathered by the investigation and the analyses of expert consultants retained by the Commission, the Special Counsel determines that at least \$1.5 billion of the TAPS expenditures were imprudently incurred and, under established regulatory doctrine, should be excluded from transportation tariffs charged by the TAPS owner companies.

I. OVERVIEW AND QUANTIFICATION OF EXCESSIVE COSTS

On November 24, 1976, the Alaska Pipeline Commission (APC) appointed Terry F. Lenzner, Esquire, as Special Counsel to assist the Commission in its statutory responsibility to investigate the costs incurred in the construction of the Trans-Alaska Pipeline System (TAPS). On March 21, 1977, the APC instructed its Special Counsel to

prepare and transmit to the Alaska Pipeline Commission a final report detailing cost overruns in the Construction of the Trans-Alaska Pipeline System of such significance that, in the opinion of Special Counsel, the Commission should consider disallowing such costs in valuing pipeline facilities pursuant to AS 42.06.420 and AS 42.10.450. The final report must include an analysis as to the causes of cost overruns set forth therein.

The report that follows is based upon an examination of hundreds of thousands of documents, interviews with scores of individuals associated with the TAPS project, and analyses of the cost and man-hour overrun issues conducted by the staff of the Special Counsel's office and independent consultants to the office. On the basis of this investigation, the Special Counsel concludes that there are adequate grounds for the disallowance of at least \$1.5 billion of such expenditures from inclusion in tariffs subject to the Commission's jurisdiction.

The completion of this inquiry coincides with the historic delivery of the first barrel of oil through the TAPS pipeline to the terminal at Valdez for trans-shipment to the

lower forty-eight states. Special Counsel recognizes the magnitude of this technological enterprise.

In conducting the investigation, full consideration was given to the governmental, geotechnical, and logistical constraints which the project encountered. Nonetheless, the report concludes that the project could have been constructed -- without sacrifice of time or quality -- in a far more efficient and cost-effective manner.

Its builders have proudly declared that TAPS is the most expensive privately-financed project in the history of the world. This declaration may prove to be a source of embarrassment as well as pride. This report, and the analyses of our consultants, demonstrate a pattern and practice of unsound business judgments and inept management in areas crucial to effective project cost control. Serious problems related to climatic conditions, terrain, logistics, procurement, and labor should have been readily apparent, and with thoughtful planning, could have been efficiently resolved. They were not; the project was characterized throughout by a significant failure to establish timely plans and systems for cost-effective construction. The resulting escalated costs of the project should not be included in a tariff whose reasonableness is of vital concern to the citizens of Alaska and to all consumers of oil carried by TAPS.

Many of the TAPS construction problems could at least have been mitigated if the TAPS owners had accepted the expert advice of the project's auditors, construction managers, and contractors. Yet, in a number of crucial instances, the TAPS owners adamantly refused such advice, at times choosing political expediency over cost effectiveness. The report documents in detail the owners' persistent rejection of Alyeska Pipeline Service Company (Alyeska) management's advice to retain a construction management contractor for the pipeline as early as possible. The owners also rejected Alyeska's requests to expend adequate sums of money for systems planning, equipment testing, and engineering design prior to startup of construction. Based upon testimony and documents reviewed to date, it appears that the owner companies decided not to incur these expenditures primarily out of concern that such commitments might allow federal and state governmental agencies to obtain some political leverage in their regulation of the project prior to construction.

Out of apparent political expediency, the owners also decided not to "phase in" construction on a coherent schedule. While Bechtel Incorporated (Bechtel) was chosen as the Construction Management Contractor (CMC) for the pipeline and roads project because of its extensive construction experience, its "phase in" advice was flatly rejected on the grounds that bringing a full labor force to the site would create political pressure on government agencies to process permits prematurely. Clearly,

this decision played an important role in the project's dismal productivity record and serious cost overrun. We do not believe that the TAPS tariff should bear the burden of such expedient decisions.

As demonstrated in the report's analysis of labor management, the man-hour costs for the pipeline alone, by June, 1977, totaled approximately \$1.26 billion above the May, 1975 base estimate. Symptomatic of this massive overrun is that \$466 million in time lost was the direct result of the failure to implement field-level man-hour controls on a timely basis. The report's labor management analysis, extrapolated from an Alyeska study, further indicates that \$84.7 million was wasted in time card abuses - evidenced most dramatically by the case of one employee paid for 24 hours of work for each of 27 consecutive days.

Excessive labor costs were only one of a multitude of problems resulting from TAPS. The report shows that construction began before even a primitive apparatus for effective administration of the project was prepared and in place. Thus, during 1974 and most of 1975, construction went forward without effective cost controls and reporting mechanisms and without inventory and procurement controls on equipment, spare parts and material. In one instance, Alyeska did not account for more than \$100 million of 1974 expenditures until 1976.