

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2631 SCOMM 117 JOINT SPECIAL COMMITTEE ON MERGERS, 1999-2000



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SCOMM 117: JOINT SPECIAL COMMITTEE ON MERGERS, 1999-2000

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Contents: 12 files. 25 cassettes are also available of meetings held 6/11/99 - 3/21/00.

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7. BACKBONE GROUP
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Official Business

ALASKA STATE LEGISLATURE

Joint Special Committee on Mergers

State Capitol
Juneau, AK 99801

Chairman: Senator Rick Halford
Vice Chair: Rep. Joe Green
Senator Drue Pearce
Senator Johnny Ellis
Rep. Brian Porter
Rep. Beth Kerttula
Rep. Jim Whitaker

AGENDA

Friday, June 11, 1999, 9:30 am
Anchorage Legislative Information Office
2nd Floor Conference Room

- | | |
|-------|---|
| 9:30 | Convene/Executive Session |
| 10:00 | Status Report: Administration |
| 10:30 | Executive Session: Status update by attorneys |
| 11:00 | Presentation by BP and ARCO |
| 12:00 | Lunch Break |
| 1:00 | Public Testimony |

IMPACT OF BP/ARCO MERGER COMMITTEES

1. **Value**
Dan Dickinson (Chair)
Kevin Banks
Greg Bidwell
Patrick Coughlin
Jack Griffin
Nan Thompson
Richard Todd
2. **Facilities**
Bill Van Dyke (Chair)
Greg Bidwell
Nan Thompson
Dan Zobrist
3. **Marine Transportation**
Roger Marks (Chair)
Kevin Banks
Dan Dickinson
Ellen Toll
4. **TAPS**
Tina Kobayashi (Chair)
Patrick Coughlin
Jack Griffin
John Larson
Chuck Logsdon
Bill Nebesky
5. **Gas Project**
Wilson Condon (Chair)
Greg Bidwell
Roger Marks
John Shively
Jack Griffin
6. **Leasing**
Ken Boyd (Chair)
Roger Marks
Larry Ostrovsky
Nan Thompson

QUESTIONS ABOUT THE EFFECT OF BP'S PROPOSED ACQUISITION OF ARCO ON THE STATE

Value

- 1. What effect will BP's acquisition of ARCO have on the state's revenues from production taxes, property taxes, corporate income taxes and royalties?**
- 2. Should the state make any changes to its fiscal and revenue collection systems as the result of BP's acquisition of ARCO?**
- 3. What effect will BP's acquisition of ARCO have on the ANS spot price? Will BP continue to use ANS spot price as a reference price in its sales contracts?**
- 4. How will BP's acquisition of ARCO and its resulting control of more than 30% of the crude oil supplied to the West Coast market affect that market? What benefits will the state realize from this increase of BP's market power?**
- 5. How will BP's acquisition of ARCO change the way that BP sells its Alaskan crude oil?**

Facilities

- 1. If BP owns more than 70% of the North Slope facilities, how will the state be assured that other producers have access to those facilities at a reasonable cost? If reasonable access is not assured, will there be reduced competition for development of State and federal oil and gas resources on the North Slope?**
- 2. Are there any agreements, tax partnerships or contracts that would prevent BP from making the North Slope facilities available to other**

producers developing or exploring outside the unit in which the facilities are located?

3. Should the field costs (including dehydration and transportation) BP deducts from the state's royalty shares of gas and oil production from the Prudhoe Bay, Kuparuk and Duck Island units be adjusted to reflect the cost savings achieved by the ARCO acquisition?
4. Can the State ensure that BP will contract with more than one oilfield service company for each type of service, so that a variety of independent oilfield service companies continue to do business in Alaska?
5. Should the state adjust the Economic Limit Factor to reflect the operational cost savings that BP will realize after acquiring ARCO? If not, how else may the operational efficiencies BP achieves from this acquisition be shared with the state?
6. What effect will BP's acquisition of ARCO have on the existing North Slope facilities? Will any be closed, merged or scaled back?

Leasing

1. How will the proposed acquisition of ARCO affect BP's bidding strategy in the remaining oil and gas lease sales in 1999, including the NPRA lease sale? Will it reduce competition in those sales?
2. How will BP's bidding strategy change at lease sales held after the proposed acquisition is complete? Will it reduce competition in those sales? If so, will that reduction in competition diminish the total ultimate recovery of oil and gas resources on the North Slope?
3. Should the state change the way it offers acreage for lease as the result of the ARCO acquisition?
4. How will BP comply with the acreage limitations in AS 38.05.140? Will BP relinquish leases to the state? Will BP propose the formation of new units? Will the risk of losing acreage encourage BP to bring more tracts into production to avoid their loss?

5. Should the state expand the exploration licensing program to include the North Slope and Cook Inlet and license BP to explore state acreage in exchange for work commitments to the state?
6. ARCO has historically explored its prospects on the North Slope more aggressively than BP. Will the vigor and magnitude of BP's exploration efforts change after BP has acquired ARCO?

Marine Transportation

1. Will BP's acquisition of ARCO reduce competition in the movement of ANS oil to market?
2. If BP realizes marine transportation cost savings as a result of its acquisition of ARCO, will it pass these savings through to the state in the form of increased royalty and tax values? Should the state recalculate marine transportation cost deductions like the allowance for laid-up tankers based on these savings?
3. How will BP's acquisition of ARCO affect the state's ability to export its RIK oil to customers outside of Alaska? How will the consolidated ownership of the Valdez fleet affect ANS producers who sell their oil at Pump Station No. 1 or Valdez?
4. Should the State advocate changes in federal laws, such as the Jones Act and the Oil Pollution Act of 1990, to remove restrictions upon entry of additional tankers into the Valdez trade?
5. How will BP's acquisition of ARCO affect the economics of vessel replacement in relation to new oil developments on the North Slope?
6. What affect will the organization of the Alaska Transportation Company have on marine transportation?

Gas Development

1. Will BP and Exxon continue to work cooperatively on Alaska gas commercialization? Will BP and Exxon work together to develop a GTL technology appropriate for the North Slope? Will BP continue its

independent effort to find a "breakthrough, innovative technology" to lower the costs of an LNG project?

2. Will BP's focus on GTL instead of LNG gas processing technology and commitment to construct a GTL plant on the North Slope affect the State's efforts to encourage LNG gas processing technology? Would BP's current or future plans for a GTL plant on Alaska's North Slope affect the availability of gas for a state-owned LNG project? Does the acquisition mean that there is a significantly smaller chance that an economic LNG project would be developed on the North Slope?
3. Does the acquisition affect BP's incentives to engage in EOR projects in the Prudhoe, Kuparuk and other fields? Will the acquisition facilitate the use of one field's gas and gas liquids as EOR feedstock in a different field?
4. Does this acquisition make it more likely that BP will agree to further expansions of the Prudhoe Bay Unit field's gas handling capacity beyond that planned for in the MIX project? Does the Unit plan to continue to maximize NGL production even at the expense of the PBU miscible gas project?
5. How does the acquisition affect long-term gas development and access to facilities in areas such as the Foothills area of the Brooks Range?
6. Does the acquisition more closely align Prudhoe Bay Unit interests in having a large or major gas sale?

Trans-Alaska Pipeline

1. Is divestiture of all or a portion of BP share of the pipeline after the acquisition of ARCO best for the State and for competition? Divestiture to whom? Should the State purchase a working interest in TAPS? How would divestiture of all or part of TAPS affect shippers, other carriers, and in-state refiners?
2. Can the state's goals of fair tariffs, access, and revenues be satisfied through a non-divestiture solution? If so, how?

3. Should the assumptions underlying the TAPS Settlement Methodology about competition in the 1990's, throughput, ownership concentration, after-tax margin, depreciation, DR&R and other issues be reexamined as a result of the proposed acquisition?
4. How will BP's acquisition of ARCO's pipeline interest affect in-state refiners and others who ship oil on TAPS?
5. How will a single company owning 72% of TAPS affect development and exploration of new areas of the North Slope? How will BP's ownership of 72% of TAPS economically affect other North Slope producers?
6. What are the property tax implications of BP's acquisition of Arco's TAPS interests?

JOINT SPECIAL COMMITTEE ON MERGERS

James A. Palmer

Friday, June 11th 1999

Mr. Chairman and members of the Committee, for the record, my name is James A. Palmer, and I am Vice President for External Affairs in BP Exploration Alaska (BPX), which is part of the BP Amoco group. I am grateful for this opportunity to speak with you about what is an historic change occurring with BP Amoco and ARCO, and within the Alaska oil industry. The agreement for BP Amoco to purchase ARCO starts a journey towards a new future for Alaska. Two great Alaskan companies have taken the first steps towards becoming a single, more competitive Alaskan company that is positioned for the challenges and the opportunities of the 21st Century.

Over the last two months, the proposed union of our two companies has generated a serious and mature discussion throughout the state. And the hearing here to-day is a further important event in this dialog.

The simple reason for this transaction is to recapture the health and competitiveness of the industry which is the foundation of Alaska's economy. BPX and ARCO have striven to achieve everything they can *separately* to reduce the cost of finding and developing oil in Alaska's North Slope, but we need to do more to make producing oil in Alaska competitive with other opportunities in the global marketplace. The proposed combination of BPX and ARCO in Alaska is the product of a positive joint and *long-term* vision of the fullest possible development of the North Slope. We can only do this by creating greater efficiencies, reducing costs and increasing our financial strength by combining our organizations, which is necessary in order to enable greater investment. Greater investment also leads to increased output, which leads to lower unit costs, leading in turn to more incentive for greater investment -- in other words, a virtuous cycle of lower cost, greater investment and greater production. The natural consequence of this positive vision is increased revenue, long term jobs, and increased stability for the State of Alaska.

The proposed combination of BPX and ARCO in Alaska is equally driven by a virtual certainty that the alternative is a much less benign cycle, a downward spiral of higher costs, reduced investments and reduced production -- the proverbial "negative spiral." Obviously, the natural consequence of this unhappy path is reduced revenue and jobs for Alaska.

It is the positive vision of reduced costs, greater investment, greater production and the resulting benefits which brought ARCO to seek the combination earlier this year and brought both companies to agree to it, and to be here today to explain it to this Joint Committee of the Alaska Legislature. We recognize that the transaction and its potential impacts have raised questions and concerns in the months since it was announced. We are confident that the promise of this combination will, after examination and reflection, be evident to you and the citizens of Alaska you represent, as it was and is to us, and that we will all enjoy the positive effects of it in the years to come.

Mr. Chairman, these "benefits" and "positive effects" are not simply a hope that the future will be bright. The immediate benefits are embodied in concrete commitments we have pledged for the combined companies. These have been aired before in press statements, testimony earlier this year before the House, and in the "better reasoned" articles and letters in the press, but let me very briefly summarize our ten key pledges again now.

1. We will invest \$ 5 billion on Alaska over the next five year years, an increase over the combined Alaskan investment of BP and ARCO in the past five years.
2. We will increase the financial support to community organizations by 50 per cent from the current combined ARCO-BP Amoco level.
3. We will consolidate our global gas technology activities into Alaska with the objective of commercializing North Slope gas. The company will continue the

ARCO-led gas sponsor group, relocate its gas technology center to Alaska and build a \$70 million gas-to-liquids pilot plant on the North Slope.

4. We will honor all current agreements with ARCO's contractors and suppliers, and will continue to treat all business partners fairly and equitably, with dignity and respect. ARCO contractors will be able to compete for future business on a completely equal footing with other contractors, including current BP contractors. Mr. Chairman, might I just say that we have been greatly encouraged by the welcome for the BP-ARCO link given by the state's leading contractors. This confidence speaks very well for the future.
5. Organized labor will continue to play an important role in our North Slope construction activities and again we appreciate the supportive comments on the combination from several labor representatives.
6. We will continue to work cooperatively and collaboratively with all levels of government
7. We will continue our efforts to provide job and business opportunities for Alaskans.
8. BP Amoco will honor ARCO's commitments to build new "Millennium Class" double-hull tankers and is fully committed to a tanker renewal program complying with the Oil Pollution Act of 1990. Of the 11 chartered tankers currently used in BP Amoco's Alaska trade, 3 have double hulls and 6 others have double bottoms.
9. We will continue to be actively involved in state and federal lease sales, and continue to pursue exploration and development opportunities in Alaska.
10. Finally, but no less important, we will treat all our employees with respect and dignity.

Now I know there have been concerns expressed about the new company's potential size and the implications for competition within Alaska, about the influence and power we could have when this deal is approved. Mr. Chairman and members of the Committee, we've been responsible and responsive corporate citizens of Alaska for 40 years. That won't change. Indeed, as the importance of Alaska grows in BP-Amoco's global portfolio, so does our sense of responsibility to Alaskans. Our size, the experience, the skills, the financial resources and the stability we bring will be Alaska's competitive advantage, not a competitive threat. We're not competing *against* Alaska for shares of a shrinking pie, we are partnering *with* Alaska to compete together for a larger slice of the global investment pie. We can and will be an even more powerful ally of the State in helping make that bigger pie a reality for the benefit of all Alaskans.

Mr. Chairman, before closing, I would like to spent a little time talking about the process we foresee as we move forward. We are very excited about the potential for this combination, and eager to begin capturing and sharing the benefits of it, but there are practical and legal steps which must come first. On the practical side, both ARCO and BP Amoco must review their respective organizations and plan in very specific terms how the organizations can be intelligently integrated. That work is continuing in Alaska, and indeed worldwide, and will take several more months due to the inherent complexity of blending two large corporations.

And, of course there are the legal steps, which will take their own time as well. This Committee is familiar with some of that, as I believe BP Amoco and ARCO's lawyers have been speaking with the Committee's lawyers about establishing a reasonable procedure for the Committee to review the transaction. That is necessarily a complicated process, due to the various confidentiality laws and requirements involved, but it will work itself out and, I am certain can proceed in good order. A similar process is going on with the Attorneys General for Alaska and other lower 48 States, and those talks are progressing this week, as well, in Anchorage and Seattle.

The US Federal Trade Commission in Washington DC is conducting its review at the same time under the Hart-Scott-Rodino merger notification rules. In that process, the companies filed their initial notification on May 17 and expect to receive a second request for information next week. We expect the FTC review to continue through the summer and we are hopeful that we can complete all government reviews in the fall of this year. We are eager to move forward to capture the benefits of this transaction and to demonstrate in real action the positive effects it will have for the companies, the State of Alaska and its people.

Mr. Chairman, thank you for this opportunity to address the committee.

TESTIMONY TO THE ALASKA STATE LEGISLATURE JOINT SPECIAL COMMITTEE ON MERGERS

Concerns Regarding Environmental Impacts of BP Amoco's Acquisition of Arco

Kay Brown, Executive Director
Alaska Conservation Alliance
June 11, 1999

Thank you for this opportunity to share the views of Alaskans on BP Amoco's acquisition of Arco. I wish to speak on behalf of more than 20,000 Alaskans represented by the 33 conservation organizations and tourism businesses that make up the Alaska Conservation Alliance. I have long-standing experience with oil and gas issues, having served as Director of the State's Division of Oil and Gas for four years. I was elected to the Alaska State legislature five times and held leadership positions as a member of the Finance Committee.

BP Amoco's acquisition of Arco has major implications for Alaska and her environment. After the merger, BP will control approximately three-quarters of the producing oil fields in Alaska's Arctic and over 70% of the Trans Alaska Pipeline System (TAPS). The Alaska conservation community has many serious concerns with BP controlling so much of the oil industry in Alaska.

Many Alaskans also appear to have significant concerns. A recent statewide poll conducted for the Alaska Conservation Alliance by Ivan Moore Research found that 29 percent of Alaskans polled favor BP's Amoco's proposed takeover of Arco, 38% oppose it, and 34 percent don't know. Eighty-three percent (83%) of those polled favor placing conditions on the merger to protect Alaska's interests, while 9% oppose conditions and 8% don't know.

The merger raises great uncertainty over how BP and Arco will live up to significant responsibilities and commitments ranging from the immediate and complete conversion to double-hulled tankers, clean up of the oil industry's toxic waste sites in the Arctic, and funding the dismantling and rehabilitation of the Trans-Alaska Pipeline. We are concerned that the merger will weaken standards of environmental protection and conservation of Alaska's wild places. We urge the State to evaluate these and other environmental and social concerns in its review.

Double-hulled tankers in the TAPS Fleet. The overall pace and extent of conversion to double-hulled tankers in the TAPS fleet may be slashed. Last year, Arco announced its plans to construct state-of-the-art double-hulled tankers for shipping crude oil from Valdez. Arco ordered three "Millennium Class" tankers, with an option to purchase two more. These tankers exceed the standards for double-hulled vessels required by law, and were to be built in advance of the schedule for converting the U.S. tanker fleet to double-hulled vessels mandated by the Oil Pollution Act of 1990 (OPA). At the same time, BP announced its intention to build three double-hulled tankers for transport its ANS crude. However, since BP announced its plans to acquire Arco, construction negotiations for these three tankers were abruptly terminated. *Although BP has recently stated its intent to complete construction of the three Millennium Class tankers ordered by Arco, instead of six-and possibly eight-new double-hulled tankers, it appears there will only be three.* No new tankers have been added to the fleet since the Exxon Valdez oil spill. There may also be less corporate liability from future oil spills due to a new pattern of tanker ownership. BP, a foreign company, is prohibited from owning TAPS fleet tankers under the Jones Act (Merchant Marine Act of 1920). This creates a disincentive for maintaining current standards of marine safety and oil spill prevention.

ACA's recent statewide poll indicates that 90% percent of Alaskans favor requiring oil companies to use state-of-the-art double hull tankers for transporting oil in Alaska waters.

Changes in Oil Spill Response Capabilities. With the personnel cuts that inevitably will follow from a merger of this size, we have concerns about the ability of BP to develop and maintain oil spill prevention and response capabilities in the oil fields and transportation system. This is particularly troublesome given BP's risky and ill-advised development of the Northstar oil field offshore of Prudhoe Bay. This is an area for which no effective spill response technology currently exists, particularly during broken ice.

Decrease in Development of New Technologies. We are concerned that loss of competition will result in less innovation in developing new technologies to protect the environment. Often one company has accomplished what another claimed was impossible to too expensive. To the extent the current incentive to innovate is lost due to a merger, the environment will suffer.

Increase in Problems with Industry Self-Monitoring. Our community always had significant problems with the fact that regulatory agencies increasingly rely on the oil industry to monitor its own compliance with state and federal environmental laws. Within this system, multiple operations have been key to disclosure of environmental problems. We are very concerned that downsizing of industry will result in the loss of this traditional safeguard of corporate accountability. Accountability concerns on the North Slope include the clean-up of toxic sites, ensuring compliance with health and air and water quality laws and assuring maximum preservation of wilderness and wildlife habitat values.

Clean up of Toxic Waste Sites. Hundreds of old drilling waste disposal sites and over 60 contaminated sites on the North Slope need to be cleaned up. In 1988, conservation groups successfully sued Arco over Clean Water Act violations at its North Slope drilling site reserve pits. As a result, the oil companies developed new techniques for waste disposal, and are now re-injecting wastes into the oil-bearing formation. However, as of April 1998 --a decade after the lawsuit -- 253 abandoned reserve pits still had not been cleaned up. Of these, 130 belong to Arco and 49 to BP. The Alaska Department of Environmental Conservation's regulations governing the manner and time when closure of reserve pits is required are very lenient. Nothing, however, prevents either BP or Arco from more promptly in closing out their reserve pits and resolving this long-term pollution issue. With the merger there will be even less incentive for BP to clean up these waste sites.

Consolidated Control of the Trans-Alaska Pipeline System. We are also very concerned about how the consolidation of ownership in the Trans-Alaska Pipeline System will affect the environment. Among other reasons, we are concerned because of the very real impact one dominant owner-company would have on the level of environmental and safety monitoring of TAPS. Members of the environmental community have expressed interest in establishing a citizen's advisory council for the TAPS corridor and oil fields similar to the Regional Citizens' Advisory Council (RCAC) established for the Valdez Marine Terminal, but industry has opposed the idea. Meanwhile, the presidential task force mandated by OPA to evaluate the integrity and safety of TAPS was never established.

We have another concern regarding TAPS. As the law now stands, when TAPS is decommissioned, industry has complete control over the money to properly clean it up. BP's acquisition of Arco adds urgency to the failure to escrow funds collected through the TAPS tariff for the eventual dismantling and removal of the pipeline and restoration of the environment (DR&R). Both companies have garnered tremendous economic benefit from the advanced collection of these funds. Because the government failed to require DR&R funds to be escrowed, BP will have inordinate influence over public policy decisions regarding how to proceed, and will be in a position to substantially weaken DR&R requirements when the time comes for the work to be done. To assure accomplishment of the important tasks, DR&R funds should be set aside in escrow. Excess DR&R collections should also be made available for solving environmental problems associated with the closing of TAPS pump stations that began in 1996.

Protection of Alaska's special places. Finally, the consolidation of industrial development in Alaska's Arctic will give BP unprecedented political and economic influence over where and how oil and gas exploration, development and production will occur in the region. BP has lobbied aggressively to exploit the coastal plain of the Arctic National Wildlife Refuge and other environmentally sensitive areas, including the Beaufort Sea, the Colville River and Teshekpuk Lake. The acquisition will significantly increase BP's power to manipulate public policy decisions regarding protection of these unique and irreplaceable wild areas.

In summary, we ask that you look hard at this merger, and take appropriate steps to ensure that the interests of Alaskans and Alaska are protected. Thank you for your attention.

**Testimony of Richard A. Fineberg before the Alaska State
Legislature Joint Special Committee on Mergers**

June 11, 1999

Synopsis

Thank you for the opportunity to present testimony today on an issue that some oil and gas veterans are calling one of the most important since statehood — BP's proposed acquisition of ARCO. In response to this significant alterations of the landscape of North Slope resource development, I believe the State should seriously consider owner divestiture and state purchase of the Trans-Alaska Pipeline System (TAPS) as conditions of approval for the merger.¹ This proposition, developed in response to the continued consolidation of power on the North Slope, revolves around two fundamental axes:

- (1) The State should negotiate to receive ownership of TAPS, plus approximately \$2 billion. That figure represents the difference between the current value of the money the owners have collected through the TAPS tariff for the eventual dismantling of TAPS and the assessed value of the pipeline.
- (2) The state should operate TAPS on a non-profit basis, reducing shipping costs by approximately \$1.00 per barrel. This tariff reduction would (a) enhance state revenues, (b) improve the competitive position of North Slope oil and (c) remove all possibility that TAPS might be operated to inhibit competition.

A. Background

Between 1991 and 1997, six major oil companies left the North Slope; five of them turned over North Slope leases with discoveries capable of production in paying quantities to ARCO and BP. Exacerbated by an

¹ The Alaska Forum for Environmental Responsibility, Oilwatch Alaska and the Alaska Public Interest Research Group have adopted this recommendation. For additional discussion of this proposition, see my background paper, *State Ownership of TAPS: Why It Should Be Considered and How It Would Work* (April 9, 1999; available on-line at www.alaska.net/~oilwatch/aktaps.htm).

extended period of low oil prices in 1998 and early 1999, that consolidation has accelerated, culminating in the proposed ARCO-BP merger.² This pattern strongly suggests the possibility that the major TAPS owners might be using the pipeline to drive out their competitors. The TAPS Owners' Committee action requires approval by companies owning 70% of the system; after the merger, BP will own 72% of TAPS.

Historically, oil pipelines have been regulated to prevent pipeline owners from discriminating against non-owners, thereby creating a barrier preventing market entry by non-owners of the pipeline.³ Many observers believe that regulation to be lax. Because of its isolation and distance from potential markets, knowledgeable observers have viewed the Trans-Alaska Pipeline (TAPS) as a classic example of a pipeline with high monopoly potential.⁴ The latest consolidation move on the North Slope therefore raises this question: Unless TAPS is operated by an entity that does not have production interests on the North Slope, can Alaska reasonably expect companies other than BP to make significant commitments to future North Slope oil development?

The 1996 statement of Conoco President and CEO Archie Dunham after his company traded the Milne Point field to BP lends force to this concern. In an interview with *Hart's Oil and Gas Investor*, Dunham said,

² For the departures from the North Slope between 1991 and 1997 of major oil companies who found or produced oil on the North Slope, see Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope* (Anchorage: Oilwatch Alaska, 1997), pp. 5.32-5.49. For a summary of recent departures, see: Richard A. Fineberg, "BP-Arco merger burns stakes for us all," *Anchorage Daily News*, April 6, 1999 (electronic edition).

³ Inter-state shipments through TAPS are regulated by the Federal Energy Regulatory Commission (FERC); intra-state shipments are regulated by the Alaska Public Utilities Commission (APUC). Pipeline regulation takes place principally in the form of approval of tariffs, or maximum per-barrel shipping charges, which are filed annually at FERC and at the APUC. TAPS tariffs are filed in accordance with a formula known as the TAPS Settlement Methodology (TSM), which was established in 1985 by an agreement between the State and the TAPS Owners (Carriers), ending a decade of tariff litigation. FERC approved the TSM formula through the year 2011, with renegotiations beginning in 2006. For intra-state shipments, APUC approved TSM historically but declined to endorse the tariff framework for future years; at APUC, TAPS tariffs are approved annually on an interim or *ad hoc* basis, subject to challenge. In 1998 Tesoro Alaska Petroleum Co. initiated a proceeding at APUC challenging the lawfulness of TSM tariffs because TAPS tariffs were excessive.

⁴ For a summary of U.S. pipeline regulatory history, see *The Big Squeeze*, pp. 3.1-3.5, 3.16-3.19 and 3.24-3.26.

"It broke my heart to trade Milne Point, but we had to do it. All the value of that property was taken away from us in the pipeline tariffs."⁵ Conoco did not have an ownership interest in TAPS and was the only company other than ARCO and BP to operate a North Slope field. The real losers when Conoco left were the people of Alaska, whose state General Fund and Permanent Fund depend heavily on resources managed to maximize revenue by ensuring open competition on a level playing field.

B. TAPS Tariffs

The TAPS tariff, or per-barrel shipping charge, allows the TAPS owners (in pipeline rate-making lingo, "carriers") to recoup costs, plus a guaranteed profit. Unlike the shipper who owns the pipeline, a non-owner shipper pipeline pays all pipeline costs out of pocket. Any excess charges captured in the tariff will *increase* the profits of the owner-shipper while *reducing* profits of the non-owner shipper. High tariffs are the principal — but by no means the only — mechanism by which pipeline owners discriminate against non-owner shippers.⁶

By virtue of its royalty interest, the state of Alaska is, in effect, a non-owner shipper on TAPS. Because severance taxes are also calculated from a base price that removes shipping charges, pipeline tariffs also affects severance tax collections. When royalty and severance effects of pipeline tariffs are combined, every dollar included in the TAPS tariff reduces state royalty and severance tax payments by approximately \$0.23. Over and apart from the potential benefits of increased competition and improved environmental performance, closer look at the construction of the TAPS tariff and its effect on state revenue is therefore warranted from a fiscal standpoint

⁵ Leslie Haines, "Getting to the Future First" (interview with Conoco President and CEO Archie Dunham), *Hart's Oil and Gas Investor*, (reprint provided by Conoco Public Affairs Dept.). Dunham also noted that consolidation was also a factor in Conoco's departure. According to industry sources, Mr. Dunham was directly involved in Conoco's efforts to develop the North Slope in the late 1980's.

⁶ In the interest of brevity, information regarding anti-competitive effects of storage and tanker operational requirements will be not be discussed here.

The TAPS tariff is based on an annual total revenue requirement which is the sum of seven major tariff elements. Each element of the tariff is calculated in accordance with terms spelled out in the 1985 TAPS Settlement Agreement between the state and the TAPS owners. The required revenues are charged to each barrel shipped through TAPS on a per-barrel basis. The TAPS Settlement Methodology (TSM) may be most easily understood in terms of seven tariff items or elements listed, which are listed in Table 1, along with a rough estimate of the total revenue requirement and per-barrel share for each element in 1997. (The figures here are approximations; individual Carrier tariffs will differ due to factors such as the owner company's financing of capital costs.)

Table 1.

Elements of 1997 TAPS Tariff

(1.354 million bpd = 495.6 million barrels)

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

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

In a 1996 University of Wisconsin Master's Thesis, economist Antony Scott reported that the TSM tariffs exceeded reasonable, cost-based

tariffs by large margins. TSM, Scott concluded, "deviates in important ways from conventional tariff methodologies."⁷ According to Scott, over the life of the settlement, the tariff overcharges reduce the value of oil to the producers by so much that the state of Alaska loses \$4.5 to \$9.2 billion in royalties and taxes, while the Federal tax loss is \$1.9 to \$2.7 billion. Scott's estimates were stated in inflation-adjusted 1995 dollars.⁸

Scott's thesis is perhaps the most comprehensive challenge to TSM since the agreement was announced in 1985. But it does not stand alone. A recent proceeding before the Alaska Public Utilities Commission, Tesoro Petroleum has charged that recent TAPS tariffs may be as much as 140% too high.⁹

C. The TAPS Tariff DR&R Provision

Over and above the excess profits described above, the fifth tariff element in Table 1 — DR&R (for dismantling, removal of the pipeline and rehabilitation of the corridor) — has provided an *additional* gain to the TAPS owners of extraordinary proportions.¹⁰ The DR&R obligation originates in the pipeline consortium's lease agreements with the state and federal governments.¹¹ Section II-4 of the 1985 agreement establishes the basis for funding this tariff element in this statement:

⁷ Antony Scott, *The Trans-Alaska Pipeline System: The Causes and Consequences of Regulatory Failure* (Master of Science Thesis, University of Wisconsin-Madison, 1996), p. 12.

⁸ *Ibid.*, pp. 125, 131.

⁹ Statement of Tesoro counsel before the APUC during summary judgment hearing on Docket P-97-4, April 20, 1999.

¹⁰ Scott, pp. i, 59-68, 259-260.

¹¹ The lease states that during "construction . . . , operation, maintenance. . . and termination of the Pipeline System," the companies are required to "employ all practicable means . . . to preserve and protect the environment." *Agreement and Grant of Right-of-Way for Trans-Alaska Pipeline between the United States of America and Amerada Hess Corporation, ARCO Pipeline Company, Exxon Pipeline Company, Mobil Alaska Pipeline Company, Phillips Petroleum Company, Sohio Pipe Line Company [succeeded by BP], and Union Alaska Pipeline Company*, Jan. 23, 1974, p. 1. Essentially identical language appears in *Right-of-Way Lease for the Trans-Alaska Pipeline between the State of Alaska and Amerada Hess, (et al.)*, p. 1. The agreements further require the TAPS operators to "abate. . . completely, or as completely as possible using their best efforts, any . . . condition . . . arising out of construction, operation, maintenance or termination of all or any part of the Pipeline System . . . that causes or threatens to cause . . . serious

The DR&R Allowance to be included in the Total Revenue Requirement for each year to provide for the eventual dismantling, removal and restoration of TAPS is given in Exhibit E.¹²

In a settlement that marked the finale to a proceeding the Alaska Department of Law frequently described as "the largest utility rate case ever presented,"¹³ the provisions of TSM that delineate DR&R collections are remarkable in their brevity. Settlement Exhibit E consists two columns of numbers. The left-hand column of the exhibit lists the years from 1984 through 2011; the right-hand column lists the sum that the TAPS owners may collect during each year in millions of dollars, starting with \$110.377 million in 1984 and ending with \$0.796 million in 2011. As to how these figures are derived, Exhibit E is silent.¹⁴

The explanatory statement of the State of Alaska and the U.S. Department of Justice submitted to FERC with the settlement is almost as brief as the settlement phrasing itself. That statement, which is 111 pages long, discusses DR&R in one paragraph that states:

The schedule for the DR&R Allowance is found in Exhibit E of the Agreement. See Section II-4. As with the

and irreparable harm to the environment." [Agreement, p. 17; Lease, pp. 16-17.] Stipulations attached to the agreement specify that:

Upon completion of the use of all, or a very substantial part, of the Right-of-Way or other portion of the Pipeline System, Permittees shall promptly remove all improvements and equipment, except as otherwise approved in writing by the Authorized Officer [State Pipeline Coordinator on state lands], and shall restore the land to a condition that is satisfactory to the Authorized Officer [or State Pipeline Coordinator] or at the option of Permittees pay the cost of such removal and restoration. The satisfaction of the Authorized Officer [or State Pipeline Coordinator] shall be stated in writing. Where approved in writing by the Authorized Officer, buried pipe may be left in place, provided all oil and residue are removed from the pipe and the ends are suitably capped. (Stipulations for the Agreement and Grant of Right-of-Way for the Trans-Alaska Pipeline, Exhibit D of Agreement, Par. 1.10.1. Again essentially identical language appears in the state lease stipulations [Par. 1.10.1].)

¹² Settlement Agreement between The State of Alaska and ARCO Pipe Line Co., BP Pipelines Inc., Exxon Pipeline Co., Mobil Alaska Pipeline Co., Union Alaska Pipeline Co. with Respect to the Trans Alaska Pipeline System (submitted to FERC in Docket OR 78-1), June 28, 1985, p. 14.

¹³ The Alaska Department of Law described the case as "the largest" case of its kind in budget and other legislative presentations Oct. 20, 1983, Feb. 6, 1984 and January 24, 1985.

¹⁴ For explanation of how DR&R payments were established, see Scott, pp. 59-68.

depreciation schedule described below, the DR&R schedule was accelerated in order to further Protestant's [state's] objective of ensuring a declining tariff profile. The annual amounts were calculated so that when they are accumulated at a rate equal to the after-tax yield on Moody's Aa bonds, the balance will be sufficient to meet the expected costs of dismantling, removal and restoration of TAPS, stipulated for purposes of the TSM [TAPS Settlement Methodology for tariff calculation] at \$872 million in 1977 dollars [emphasis added].¹⁵

In 1985 it was virtually impossible to estimate the correct amounts to pre-collect for DR&R. Even if the date of pipeline shutdown could have been known with certainty, three estimating factors necessary to calculating the correct pre-collection of DR&R through the tariff were uncertain or unknown at that early date: The amounts specified in Exhibit E of the settlement agreement were based on assumptions regarding (1) the return the owners would realize from the pre-collected funds during the intervening years between collection and expenditure, as well as (2) the rate of inflation during those years. Since the DR&R collections constituted income until the funds were expended, the pre-collected funds would be taxable; the DR&R collections were therefore "grossed up" by (3) the estimated income tax. The almost inevitable errors in all three early estimates created DR&R over-collections, resulting in a windfall of enormous proportions for the TAPS owners. According to Scott, "... in 1995 dollars, the carriers' DR&R 'fund' is between \$9-\$13 billion too large. The sum will grow larger still if the date when DR&R disbursements must be made is postponed (rather than conducted between 2012 and 2015, as TSM assumed)".¹⁶

Because the TSM did not require the tariff collectors to escrow the DR&R funds, those funds passed directly into the hands of the TAPS owners. That's money represents after-tax profit for the TAPS owners,

¹⁵ State of Alaska and U.S. Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in Support of Settlement Offer*, June 28, 1985 (Federal Energy Regulatory Commission Docket No. OR 78-1), pp. 29-53. *Explanatory Statement*, pp. 30-31.

¹⁶ Scott, pp. 259-260.

with all dismantling charges paid — over and above the annual profits tallied in Item 7 of the tariff in Table 3. For purposes of this analysis, there is no need to figure out exactly how much the TAPS owners will make from this provision of TSM; it is enough to know that DR&R has been grossly over-collected. What is important to define is the present value of this windfall to the TAPS owners.

Through 1998, TAPS shippers paid approximately \$1,535 million in TAPS tariffs for DR&R, or 98% of the estimated total DR&R tariff stipulated as part of the TSM. Scott estimates the after-tax value to the TAPS owners of the pre-collected DR&R funds at the end of 1998 at \$4.07 billion to \$4.56 billion.¹⁷ My preliminary update of Scott's earlier work indicates that the imputed value of DR&R collections at year-end 1998 was \$5.0 billion in 1999 dollars.

Perhaps because it was portrayed as revenue-neutral by the proponents of the settlement, the DR&R provision received little attention in the 1985 settlement reviews.¹⁸ The staggering size of the DR&R windfall to the TAPS owners resulting from this tariff element was not recognized until the Alaska Public Utilities Commission's Staff Expert Witness quantified the gain to the Carriers in his December 1986 analysis.¹⁹

D. A Scenario for State Purchase and Operation of TAPS

These concerns might be water under the bridge if it weren't for the fact that pipelines are regulated and mergers are reviewed for very similar reasons. In connection with the drastic changes in the state's economic

¹⁷ Scott, Tables A1.4 and A1.5.

¹⁸ For an analysis of major views of the TAPS settlement, see: Richard A. Fineberg, *The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes* (Alaska State Legislature [Supplemental Report]), Feb. 5, 1990.

¹⁹ Rudolph L. Bertschi, *Prefiled Testimony of R.L. Bertschi* (Staff Expert Witness testimony, in Alaska Public Utilities Commission Docket No. P-86-2, Dec. 17, 1986), pp. 63-70 and Exh. RLB-15, Schedules 1 and 2 (reprinted in Richard A. Fineberg, *Hidden Billions: The TAPS DR&R Provision* [prepared for Stan Stephens, August 1992], pp. 47-57).

landscape, it therefore seems reasonable to consider carefully the possibility that TAPS may have been used in the past to stifle competition to the major owners and is even more liable to be used in that manner under one owner. In the process of preventing problems associated with the proposed merger in an equitable manner, it may be possible to correct some of the problems past studies have identified with the 1985 TAPS settlement.

In broad economic terms, these aspects of the TAPS tariff stand out: Through the mechanisms of front-loaded (hyper-accelerated) depreciation schedule and recovery of deferred return, capital investment in TAPS appears to have been largely repaid.²⁰ Rapid depreciation has also reduced the value of TAPS for property tax purposes. TAPS is valued today at approximately \$3.0 billion for property tax purposes. At the same time, through the pre-collection of DR&R, the TAPS owners have also received the use of a cash windfall estimated by the author at \$5.0 billion. Based on this information, it makes sense for the state of Alaska to pursue the possibility of purchasing TAPS and taking over the DR&R liability, along with the present value of the funds the TAPS owners have pre-collected for that purpose.

If the estimated value of the TAPS DR&R collections is placed at \$5.0 billion, the net result of the transaction would be a transfer to the state of Alaska of TAPS and associated aspects, plus approximately \$2.0 billion in cash. That amount could be deposited into an escrow account for future DR&R expenditure; the escrowed, publicly-held TAPS DR&R fund could be supplemented, as necessary, in amounts to be determined by modelling.

In Table 2, the right-hand column shows the effect on the 1997 TAPS tariff of the tariff reductions resulting from state take-over and operation of TAPS on a non-profit basis. Under this regime, profit and income tax elements — tariff elements (5) and (7) — would no longer need

²⁰ More research in this area is needed. In the few available public accountings of TAPS tariff elements, the distinction between capital funds that repay original investment and those earmarked to cover subsequent capital investments in TAPS is not always clear. When these distinctions are clarified so that the resulting elements can be modelled to assure appropriate capital repayment on investment, the likely net effect will be to reduce the tariff significantly.

to be collected. Even with a hefty per-barrel charge to cover additional capital expenditure and contributions to the DR&R fund, the resulting tariff reduction (item [8]) would allow the state to deliver oil to Valdez at a tariff well below that currently charged by the TAPS owners, enhancing the competitiveness of North Slope oil while increasing state royalty and severance returns.

Table 2.

Revised Elements of TAPS Tariff
(Based on 1997 tariff; see Table 1, above)

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

Notes:

1997: See Table 1, above.

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

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

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

While modelling of fiscal effects of state operation of TAPS is beyond the scope of this analysis, it is possible to get a sense of the consequences of this proposal by making adjustments to the model presented in the author's 1998 report on TAPS profitability. For purposes of this analysis, the TAPS tariff elements in that report were altered for

1997 and 1998 calendar year operations by reducing the TAPS tariff to \$2.00 per barrel for each year through the tariff adjustments discussed in the preceding section. The tariff reductions resulting from state operation of TAPS increased state revenue in 1997 and 1998 by a minimum of \$85 million per year.²¹

E. State Management of TAPS

While the concept of state management of TAPS may be attractive from a fiscal perspective, there are other policy questions to consider. Important concerns regarding state management of TAPS include (1) effective management, (2) the related question of cost control and (3) environmental policy.

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

Regarding cost control — already a problem for the TAPS owners — pipeline managers could use the same techniques to promote cost savings that Alyeska now uses. At present, Alyeska managers remind employees that the success of future North Slope development depends on holding transportation costs down so that Alaskan oil can compete on the global market and employees receive year-end bonuses for cost-savings and safety. Managers could continue to make effective use of both techniques.

From an environmental standpoint, there are two apparent benefits of state take-over and management of TAPS: (1) In day-to-day operations, under public ownership the TAPS operators would be under less pressure to cut corners because they would no longer be hammered by the cost-cutting demands of shareholder-conscious executives on the TAPS Owners'

²¹ This is a minimum estimate. Preliminary modelling of the TAPS capital structure is likely to result in further tariff reductions. (See preceding footnote.)

Committee. (2) As TAPS shutdown nears (at some point in the future), the state is liable to face this dilemma: The North Slope producers may determine that the need to commit funds for DR&R (previously collected but not escrowed) will deprive those companies of capital that might otherwise be used to extend temporarily the life of the North Slope. In this situation, the state may be under pressure to back down from environmental requirements to restore the pipeline right-of-way to pre-construction condition.

F. TAPS Divestiture to a Private Corporation

To the extent that the concerns discussed in this analysis are based on a pattern of past behavior, it follows that requiring ARCO-BP to divest ARCO's share of TAPS (22%) will merely perpetuate — rather than correct — the unhealthy situation that has led to BP's domination of North Slope development. Additionally, despite its guaranteed profit on TAPS, an independent company might be reluctant to buy TAPS if that company were acquiring the TAPS DR&R liability without the funds to perform that obligation (as noted earlier, 98% of the DR&R money has already been collected, but the funds were not escrowed).²² Finally, from the perspective of competition, the preliminary analysis presented here suggests that the state is in a better position to promote competition by operating TAPS at a significantly lower tariff. In fact, that tariff could be so much lower that it could include a payment in lieu of property taxes, thereby solving a long-standing problem of the pipeline corridor communities, as shown in Table 2.

G. Conclusion: Why the State of Alaska Should Buy TAPS

A number of studies arguing that TAPS tariffs under TSM are excessive combine with the departure of Non-owners from the North Slope to provide strong indication that TAPS has functioned to inhibit

²² In 1992 an investment analyst told the author he had recommended that an investor not buy North Slope production interest because DR&R liability issues on the North Slope had yet to be decided. In the case of TAPS, the problem would be magnified.

competition. If this has been the case, BP's proposed acquisition of ARCO would inevitably make things worse. Moreover, the proposed merger would create a stunning corporate powerhouse capable of determining almost single-handedly the future of Alaska's most important revenue-generating industry. With ARCO's interests subordinated to those of BP by the proposed merger, some observers believe that Exxon — at present the third major North Slope producer as ARCO's silent partner at Prudhoe Bay — might decide to sell out and leave Alaska. Consider the power of the BP-ARCO combine to dictate its own economic terms: If BP-ARCO disagrees with the state's position on a fiscal matter (or simply wants a greater share of the revenue from a field), the enlarged new international oil giant could threaten to divert its capital to projects elsewhere around the globe. And if the state asks BP-ARCO to spend more on environmental amenities, the new behemoth might respond by directing its dollars to investment in places with less stringent environmental standards.

Purchase of TAPS under terms outlined in this report could — without cash outlay — enhance the state of Alaska's ability to deal with these problems while the ability to accomplish the following major policy objectives:

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

I have attached some recent newspaper commentaries on this concept, as well as the Executive Summary of a 1997 report I prepared on TAPS anti-trust issues. If you have any questions, I would be hnappy to try and answer them.. Thank you for your time and your efforts.

Richard A. Fineberg, who lives outside Fairbanks, writes and consults primarily for government and non-profit groups on economic and environmental issues relating to oil development in Alaska. In addition to serving as a senior advisor to the Governor in oil and gas policy between 1987 and 1989, he has prepared several reports on North Slope development issues between 1990 and 1992. He is the author of Pipeline in Peril: A Status Report on the Trans-Alaska Pipeline (Valdez: Alaska Forum for Environmental Responsibility, 1996), The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope (Anchorage: Oilwatch Alaska, 1997) and How Much Is Enough? Estimated Industry Profits from Alaska North Slope Production and Associated Pipeline Operations, 1993 - 1998 (Anchorage: Oilwatch Alaska, 1998 [preliminary report]).

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State could acquire the pipeline

Given dismantling liability, it might not cost a dime

Editor's note: This is the first of a two-part commentary on pipeline issues raised by the proposed merger of BP and Arco.

The state of Alaska should consider acquiring the trans-Alaska pipeline system for operation on a non-profit basis as a condition of BP's proposed acquisition of Arco. Oilwatch Alaska, the Alaska Forum for Environmental Responsibility and the Alaska Public Interest Research Group adopted this proposal April 15.

Much of the discussion in the six weeks since BP announced the decision to acquire Arco has focused on the pipeline, but opinions vary about what (if anything) should be done to ensure that BP does not use its stranglehold on the pipeline to inhibit competition on the North Slope. Under the proposed Arco-BP merger, the new company would own 72 percent of the pipeline link between Deadhorse and Valdez.

Pipelines are regulated because they are natural monopolies. Producer-owned pipelines are of particular concern because pipeline owners can use their control to drive competition out of business, either through excessive tariffs (shipping rates) or discriminatory practices.

The federal agency that oversees oil pipeline tariffs is the Federal Energy Regulatory Commission. The agency practices what it currently calls "light-handed" regulation. Under this policy, the agency routinely rubber-stamps pipeline shipping rates (tariffs) instead of providing close scrutiny to ensure that pipeline owners do not discriminate against non-owner shippers.

Because transportation costs are subtracted before royalty and severance taxes are calculated, the state is the largest non-owner

Richard Fineberg

Guest Opinion



shipper on the pipeline. In 1985, after a decade of litigation, FERC approved a settlement between the state and the pipeline owners that established a tariff methodology for the pipeline. In a 1996 University of Wisconsin master's thesis, "The Trans-Alaska Pipeline System: The Consequences and Causes of Regulatory Failure," Antony Gordon Scott estimated that between 1977 and 2011 excessive pipeline tariffs collected under that settlement will cost the state treasury an estimated \$4.5 billion to \$9.2 billion (in 1995 dollars).

In a 1995 filing before the FERC, the Alaska Department of Law acknowledged that instead of assuring competition, through 1995 the pipeline settlement agreement operated to guarantee that the pipeline owners never had to cut tariffs to compete with each other. Consequently, the pipeline owners never filed a tariff below the maximum allowed under the settlement formula.

During the first half of this decade, five major oil companies left the North Slope, turning over North Slope leases with discoveries capable of production in paying quantities to major pipeline owners Arco or BP. The state denied that these departures had anything to do with pipeline regulation. State officials maintained that oil companies were heading south in a herd as a result of efforts to consolidate operations in the name of efficiency. After all, they said, Arco and BP were still competing with each other and smaller companies—Forcenergy, Union Texas, Anadarko, and Fina, for example—were showing interest in the North Slope.

In the face of extended low oil

prices during 1998, Arco took over Union Texas; BP bought Amoco, a major U.S. producer with minor production interests at Endicott; Exxon and Mobil announced their plans to form the world's largest oil company; low oil prices recently pushed an over-extended Forcenergy into bankruptcy.

This pattern of departures from the North Slope is a serious issue that should be considered carefully during deliberations over the proposed Arco-BP merger. In its 1996 final report, the Governor's Oil and Gas Policy Council worried that "over 95 percent of non-royalty oil is owned by three major integrated oil companies (Arco, BP, and Exxon)." According to the council, "having more oil industry participants would be advantageous for the state" and "Alaska would benefit from more oil and gas players—large, medium, and small." The proposed Arco-BP merger culminates a trend running diametrically opposite to this central premise.

The extent to which pipeline tariffs and operating arrangements are responsible for the exodus of companies from the North Slope cannot be known with certainty, but the case for state ownership of the pipeline does not rest on proving this case. Rather, the proposal derives from the analysis of the pipeline shipping costs and the pipeline tariff structure established by the 1985 settlement agreement.

At this point pipeline tariffs have repaid most of the owners' original capital costs through accelerated depreciation and cover all costs, including a guaranteed profit for the owners on their investment. The tariff also allows the owners to benefit from accelerated collection of funds to be used at some unspecified date for the dismantling and removal of the pipeline and restoration of the pipeline corridor (DR&R).

The latter provision is central to the take-over proposal. Scott estimates that this overly generous provision to the 1985 set-

tlement allows the owners of the pipeline to pocket an excess or hidden profit of \$9 billion to \$13 billion in tax-paid 1995 dollars.

By negotiating to take over the pipeline and assume this future liability in exchange for the present value of the DR&R funds pre-collected through the tariff, the state could acquire the pipeline without outlay of state revenue and operate the pipeline on a non-profit basis. By offering a lower pipeline tariff, this new arrangement would increase state revenue significantly while ensuring that the pipeline is not used to stifle competition.

Preliminary examination of the tariff structure also indicates that by inserting a quasi-public corporation in the place of the present pipeline owner's committee as a condition of the merger, these benefits can be achieved while setting aside sufficient funds to meet future DR&R requirements and providing the pipeline communities a guaranteed payment in lieu of taxes.

While the broad outline is clear, these are extremely complicated issues. Many aspects of this proposal bear close scrutiny. Because the proposed BP-Arco combine would wield enormous power in Alaska and considerable power over the nation's domestic energy supply, now is the time for that scrutiny. Alaskans should insist on a careful, independent review of this proposal to make sure that the remaining North Slope producers do not use their control of the pipeline to reduce state revenues and shut out competition.

Richard A. Fineberg, who lives outside Ester, prepared "State Ownership of TAPS: Why It Should Be Considered and How It Would Work," for Oilwatch Alaska and the Alaska Forum for Environmental Responsibility shortly after BP announced its intention to take over Arco. Fineberg, who served as a senior adviser to the governor on oil and gas policy from 1987 to 1989, now consults primarily for government and non-profit groups. His report is available on-line at: www.alaska.net/tlide/oilwatch/ak-taps.htm.

Tomorrow: Why the state needs an independent review of the issues.

S TO THE EDITOR

FAIRBANKS DAILY NEWS - MINER (5/17/99) A1

"Penny wise and pound foolish" characterizes the push for immediate development.

pay them well enough? Or are they paid well but just not treated right? What's wrong with

the woman. They mature faster, think faster, are stronger (!), and live longer. Women are creators,

state constitutional privacy rights to personal marijuana possession.

Pipeline ownership needs review

Editor's note: This is the second of a two-part commentary on pipeline issues raised by the proposed merger of BP and Arco.

Three recent developments support careful review of the proposal that the state should take over the trans-Alaska pipeline system as a condition of BP's proposed acquisition of Arco. These developments also suggest the need for independent, public scrutiny of the state's evaluation of this proposal:

1) An unpublicized court trial in Juneau last year that resulted in a \$10 million judgment against Alyeska Pipeline Service Co. demonstrates the problems Alaska's resource managers will have dealing with the immense power that oil giant BP will wield over the course of Alaska development—in part through its control of the pipeline—if the proposed merger with Arco goes through unchallenged.

2) Last month Tesoro Petroleum presented preliminary oral arguments before the Alaska Public Utilities Commission claiming that tariffs charged by the pipeline's owners may be 140 percent too high.

3) Two weeks ago marketers at Anadarko Petroleum Corp. called me. They were trying to figure out what problems they will have with pipeline tariffs as the 22 percent (and the only independent) owner of the Alpine field, now 78 percent owned by Arco, when that new field, currently under development, goes into production shortly after the turn of the century.

Pipelines are regulated for one fundamental reason: A pipeline is a natural monopoly that the owners may be tempted to use to stifle or gain unfair advantage over competitors. This can be

Richard Fineberg

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done through high shipping charges (tariffs), which they pay to themselves for transporting their own oil but independent shippers pay out of pocket, or through discriminatory operating procedures.

Can we trust state officials to review and act on pipeline-related concerns? Unfortunately, all four of the individuals the governor assigned to review the merger are identified with the state's past actions—and inaction—on pipeline tariffs. Moreover, the state's response to all three issues identified above suggests that the state agency primarily responsible for pipeline policies, the Department of Law, appears to be indifferent to the concerns of independent operators.

In the Juneau trial, tanker operator Maritime Endeavor charged that Alyeska has used pipeline terminal operating procedures to keep its tanker out of Valdez. According to Maritime Endeavor, its tanker Cove Endeavor would have been the only independent vessel in the pipeline's West Coast trade. After a three-week trial, then-Superior Court Judge Walter Carpeneti concluded that Alyeska imposed financial requirements on the independent tanker that were unreasonable and beyond the law. As a result, he wrote, the tanker's owners demonstrated losses totaling more than \$10 million.

Although a subsequent out-of-court settlement terminated these proceedings, the facts laid

out in the judge's vacated trial decision lend strong support to concerns that BP, through its pipeline subsidiary Alyeska, has used its control over Alyeska to drive competing tankers out of the pipeline trade.

When I questioned pipeline operating arrangements in late 1997, ADOL dismissed these concerns as entirely speculative. According to the department, no company had ever complained. In making that claim, ADOL overlooked or ignored the Maritime Endeavor complaints, then pending in two court actions in Juneau—the state complaint, then headed for trial, and a federal antitrust complaint, based on the same set of facts (the latter was dropped as part of the settlement after Maritime Endeavor's apparent vindication in the trial of the former.)

While the APUC is treating many of the facts on the Tesoro challenge as confidential, the broad outline—the pipeline tariffs are excessive—confirms the conclusions of a University of Wisconsin master's thesis which found that the 1985 pipeline tariff settlement agreement before the Federal Energy Regulatory Commission allows the pipeline owners to charge grossly excessive tariffs. The result, according to author Antony Gordon Scott, is the transfer of billions of dollars of profits to the pipeline owners at the expense of independent shippers and the state of Alaska, all to the detriment of competition on the North Slope.

At the Tesoro APUC hearing, ADOL's representative sided with the pipeline owners, telling the APUC that the pipeline tariff settlement—an agreement negotiated by the department and its consultants in 1985—produced tariffs that were just and reasonable.

Anadarko's prognosis as a

non-owner shipper on the pipeline may not be good. Non-owner shippers on the pipeline who have fought allegedly discriminatory shipping arrangements—often without state help—include Occidental and its former partner at Milne Point, Conoco. Discussing his company's decision to trade the Milne Point field to BP in a 1996 interview with Hart's Oil & Gas Investor, Conoco President and CEO Archie Dunham said, "It broke my heart to trade Milne Point, but we had to do it. All the value of that property was taken away from us in the pipeline tariffs."

Despite this history, a knowledgeable ADOL attorney dismissed Anadarko's concerns with lofty indifference, noting that the tariffs were a matter of public record when Anadarko decided to invest in Alaska. Therefore, he reasoned, if the company didn't know that it might have problems with pipeline tariffs, it should have.

Past state failures and indications of the current inability of state officials to deal effectively with pipeline issues dictate that concerned citizens should insist on special measures to assure a public review process that will safeguard the public's interest in open competition on the North Slope. To assure objective review and public confidence in the state's ultimate position on the proposed merger, officials must find a way to provide reviewers access to all materials and deliberations related to the merger proposal.

Richard A. Fineberg, who lives outside Ester, prepared "State Ownership of TAPS: Why It Should Be Considered and How It Would Work," for Oilwatch Alaska and the Alaska Forum for Environmental Responsibility shortly after BP announced its intention to take over Arco. Fineberg, who served as a senior adviser to the governor on oil and gas policy from 1987 to 1990, now consults primarily for government and non-profit groups. His report is available on-line at: www.alaska.net/tilde/oilwatch/ak-taps.htm.

TO THE **EDITOR**

FAIRBANKS Daily News-Miner, 5/18/99

cause of owner ignorance or intolerance. The FNSB will not permit a dog or cat to be adopted until 8 weeks of age and the animal leaves the shelter spayed or neutered.

The reason this picture hits so hard is that I took a 4-week-old

Sherri Nuttall
North Pole

Consider costs

May 11, 1999

To the editor:

I hope politicians and officials at Golden Valley Electric Associa-

One potential alternative would be a local gas powered generating plant. There has been talk in Juneau about a state-funded gas line. If this talk is serious, then the Legislature should explore such options

rather than subsidize a questionable power line project across prime waterfowl breeding habitat.

John K. Petersen
Fairbanks

P.A. 4

OPINION

Sam Bishop, Opinion Page Editor; 459-7574; e-mail: letters@newsminer.com

FAIRBANKS

Daily News - Miner

"Independent in All Things... Neutral in None"

Established in 1903

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Pipeline politics

It was Gov. Bill Egan who proposed that Alaska own the trans-Alaska oil pipeline as a means of protecting Alaska's long-term interests.

The enormous risk, cost and political uncertainty that plagued early pipeline plans led to the rejection of Egan's vision for a state-owned pipeline in the early 1970s.

The oil companies took the risk and went on to create one of the great engineering achievements of all time.

A quarter-century later, some of the questions that Egan raised about what's in the best long-term interest of Alaska regarding the pipeline remain.

What brings this issue to the forefront today is the proposed merger between British Petroleum and Arco, the biggest change in the history of the oil industry in Alaska.

In a two-part series on this page, Fairbanks consultant and oil analyst Richard Fineberg has raised many pertinent questions that deserve serious study by Alaskans and their elected officials about the pending combination of the two oil giants.

Fineberg has a long history as an oil industry critic and researcher. He has a well deserved reputation for doing his homework and for ferreting out essential facts. He has often been at odds with the oil industry and state officials, but those disputes center on Fineberg's interpretation of events and not his rendition of the underlying facts.

You don't have to agree with his opinions about the industry to respect his persistence and research ability. He is a former UA professor, a former journalist and a former senior adviser to the governor on oil and gas who has spent more than a quarter-century studying oil in Alaska.

We don't believe the case has yet been made that as a condition of support for the BP-Arco merger, that the state should take over ownership of all or a part of the trans-Alaska pipeline.

What is clear, however, is that the idea that Alaska should own all or part of the pipeline deserves serious study by the Knowles administration and the Legislature.

There are any number of reasons why this may be a good idea: fostering healthy competition among oil companies, protecting the state's royalty interest in oil and gas fields, ensuring fair tariffs and developing future oil prospects.

The state of Alaska has an ownership interest in the oil and gas on the North Slope. The public and our elected officials might be in a better position to guarantee that Alaska is getting a fair shake if the state had a similar ownership position in the pipeline.

Another issue raised by Fineberg is that of the funding mechanism set up in the mid 1980s to pay for the eventual removal of the pipeline amounted to a large prepayment and a financial windfall for the oil companies.

Under the tariff settlement, the oil companies were allowed to deduct money during the early years of pipeline operation to pay for dismantling the pipeline in the distant future.

The pipeline owners have long since collected the money to do this job, though it will be decades before the pipeline has to be removed. When the time value of money is considered, the future worth of those early withdrawals runs into billions of dollars beyond the actual dismantling costs.

For purposes of property tax, the pipeline is valued today at about \$3 billion. Fineberg cites sources asserting that the current value of the money already withdrawn by the oil companies to dismantle the pipeline exceeds that figure by more than \$1 billion, under a mid-point conservative estimate.

He goes on to suggest that the state could assume ownership of the pipeline from the oil companies and an outlay of state funds would not be necessary.

Under this scenario, the companies would pay the difference between the pipeline value for tax purposes and the value of the money already withdrawn to dismantle the pipeline.

The oil companies would pay the state more than \$1 billion in cash and the state would acquire the responsibility to take the pipeline apart in the future.

Fineberg's ideas are provocative and certain to spark heated arguments. With the BP-Arco merger now on the table, they are worth a full and complete examination.



LETTERS ^T

ample, bite inhibition, social skills and how to behave in the animal world.

State ownership of pipeline could stop abuses

By RICHARD A. FINEBERG

To ensure that BP Amoco does not use control of the trans-Alaska pipeline to inhibit competition on the North Slope, the state should consider acquiring the pipeline for nonprofit operation. Oilwatch Alaska, the Alaska Forum for Environmental Responsibility and the Alaska Public Interest Research Group have endorsed this proposal.

Pipeline operations are regulated because of their monopoly potential. Of special concern are producer-owned pipelines, which can drive competition out of business through excessive tariffs (shipping rates) or other discriminatory practices. The proposed Arco-BP merger would increase BP's share of the pipeline from 50 percent to 72 percent.

Instead of providing close scrutiny to ensure that pipeline owners do not discriminate against nonowner shippers, the federal Energy Regulatory Commission tends to rubber-stamp pipeline tariffs under a policy called "light-handed regulation." Because transportation costs are subtracted before royalty and severance taxes are calculated, the state loses when regulation fails.

In a 1996 University of Wisconsin master's thesis,

"The Trans Alaska Pipeline System: The Consequences and Causes of Regulatory Failure," economist Antony Scott estimated that by 2011 excess pipeline tariffs will cost the state treasury between \$4.5 billion and \$9.2 billion (in 1995 dollars). Was it coincidence that five major oil companies that left the North Slope in the early 1990s each turned over significant oil discoveries to Arco or BP?

Nonowner shippers who have fought pipeline shipping arrangements include Conoco and, more recently, Occidental Petroleum Corp. In 1993, Conoco left Alaska, trading its Milne Point and Badami properties to BP. Conoco's president later said one reason his company reluctantly gave up Milne Point was that "all the value of that property was taken away from us in the pipeline tariffs."

In its 1996 final report, the Governor's Oil and Gas Policy Council recommended that Alaska establish policies that encourage wider participation in oil and gas development. The proposed Arco-BP merger culminates a trend in the opposite direction.

As recently as late 1997 state officials ignored these warning signs and denied that anything was amiss on the North Slope. While oil compa-

nies were heading south in a herd, state officials complacently noted that Arco and BP were still competing with each other and smaller companies — Forcenergy Inc., Union Texas, Anadarko and Fina, for example — were active on the North Slope.

In the past 18 months, Arco bought Union Texas, BP took over Amoco, and Exxon and Mobil announced their wedding, while low oil prices pushed Forcenergy into bankruptcy. Finally, BP and Arco announced their intention to merge.

Meanwhile, other events raise questions about the domination of the pipeline by the major North Slope producers. Last month, Tesoro Petroleum asked the Alaska Public Utilities Commission to reject the tariffs charged by pipeline owners because they are as much as 140 percent too high.

An unpublicized 1998 court trial in Juneau demonstrated the immense power that BP will wield over Alaska's future development if it is allowed to acquire Arco's share of the pipeline. In that trial, Maritime Endeavor Associates won \$10 million in damages by demonstrating that the Alyeska Pipeline Service Co. unlawfully used pipeline terminal requirements to chase the only inde-

pendent tanker in the pipeline trade out of Valdez.

The state's response to both cases reflects surprising indifference to the problems of independent operators. In response to the Tesoro challenge, the Alaska Department of Law's representative sided with the pipeline owners, telling the APUC that the tariffs were just and reasonable. And long after the Juneau tanker case had been filed in court (along with a companion federal antitrust suit, later dismissed as part of the settlement after the tanker company prevailed in the state case) the Department of Law strangely insisted that pipeline-related antitrust concerns were "only speculation, not facts," and that no company had ever raised pipeline antitrust concerns with the state.

The extent to which pipeline tariffs and operating arrangements are responsible for the exodus of companies from the North Slope is debatable, but the case for state ownership of the pipeline does not rest on proving this link. Rather, the proposal derives from the analysis of the pipeline shipping costs and the tariff structure established by a 1985 settlement agreement between the state and the pipeline owners.

In addition to allowing excessive tariffs, the pipeline agreement allows the pipeline owners to benefit from accelerated collection of funds to be used at some unspecified date for the dismantling and removal of the pipeline and restoration of the pipeline corridor, or DR&R.

The latter provision is central to the takeover proposal. According to Scott's 1996 thesis, the overly generous terms of the 1985 settlement approved by the federal Energy Regulatory Commission allow the pipeline owners to pocket an excess or hidden profit of \$9 billion to \$13 billion in tax-paid 1995 dollars. By negotiating to take over the pipeline and assume this future liability in exchange for the present value of the DR&R funds precollected through the tariff, the state could acquire the pipeline without outlay of state revenue.

By operating the pipeline on a nonprofit basis, the state could lower tariffs, significantly increasing state revenue. With a quasi-public corporation in the place of the present pipeline Owners' Committee, the state can ensure that the pipeline enhances competition and provides the pipeline communities a guaranteed payment in lieu of property taxes, while

setting aside sufficient funds to meet future DR&R requirements.

Despite their shaky record, state officials have correctly noted that the radical consolidation of power that BP will achieve on the North Slope through its proposed merger with Arco raises public policy issues of tremendous import. Although the potential economic benefits of state acquisition of the pipeline warrant serious scrutiny, both policy issues and the mechanics of implementation require careful consideration. To ensure objective review of pipeline-related issues and public confidence in the state's ultimate position regarding the proposed Arco-BP merger, state officials also must find a way to allow meaningful public involvement in deliberation on these important questions.

J. Richard A. Fineberg prepared "State Ownership of TAPS: Why Should Be Considered and How Would Work," for Oilwatch Alaska and the Alaska Forum for Environmental Responsibility shortly after BP announced its intention to take over Arco. Fineberg, who served as a senior advisor to the governor on oil and gas policy from 1987 to 1991, now consults primarily for government and nonprofit groups. His report is available on-line.

www.alaska.net/~oilwatch/aktaps.htm

The Big Squeeze:

TAPS and the Departure of Major Oil Companies **Who Found Oil on Alaska's North Slope**

A Report to Oilwatch Alaska

by

Richard A. Fineberg

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The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope

Executive Summary

This study for Oilwatch Alaska suggests that the major owners of the Trans-Alaska Pipeline (TAPS) — ARCO, British Petroleum (BP) and Exxon — may be strangling their competition in the same manner that the Rockefeller Trust did in its competitors before that tightly controlled corporate empire was broken up by antitrust action in 1911. Since 1990, seven of the largest oil companies in the nation have sold, traded or abandoned all or part of their North Slope holdings. In every case but one, the property was acquired by major TAPS owners ARCO and/or BP.

ARCO, BP and Exxon also produce more than 95% of all North Slope oil. These three companies retain legitimate profits from TAPS, as well as any overcharges allowed by the complicated scheme for setting tariffs (shipping charges) that governs TAPS; for North Slope producers who are not TAPS Owners, all costs associated with the pipeline are true, out-of-pocket costs. Due to its position as royalty and tax collector, the State of Alaska is the primary victim of this arrangement. According to a recent study, TAPS tariff overcharges will reduce the value of North Slope's contribution to the Treasury of the State of Alaska by \$4.5 to \$9.2 billion in royalties and taxes between 1977 and 2011; that's \$7,500 to \$15,300 for every single Alaskan. According to the same study, the portion of this money denied the Alaska Permanent Fund, if invested at a corporate bond rate, would have enlarged the Fund by \$6.7 to \$14.3 billion by the end of 1995 (all figures are in inflation-adjusted 1995 dollars).

These revenue losses to the State of Alaska and its citizens do not include the windfall to the TAPS Owners resulting from a generous provision of the 1985 TAPS Settlement Agreement between the State and the TAPS Owners that has allowed the owners access to more than \$3 billion they have supposedly collected for dismantling the pipeline at some future date.

Perhaps even more importantly, these losses do not reflect the possible revenue consequences to the State of Alaska and its citizens of lost production due to the anticompetitive effects of TAPS tariff management. While the Governor proudly proclaims Alaska is "open for business," the North Slope cutbacks and company departures discussed in this report are only the foremost among numerous indications that TAPS may impede the development the State purportedly seeks to encourage. This report

therefore addresses the manner in which oil pipelines operate, how they are governed and the role played by the State of Alaska in this important but frequently overlooked area.

The following transactions highlight the recent exodus of major oil companies from the North Slope:

- When Conoco left Alaska at the end of 1993, the nation's eighth-ranked producer traded its 70% interest in the producing Milne Point oil field to BP, the company that owns 50% of TAPS. In that trade, BP also gained extensive heavy oil accumulations at Milne Point, as well as another North Slope discovery it is now developing (Badami).
- As Conoco departed, Amerada Hess — the nation's 11th-ranked producer of oil — was trading extensive exploration rights west of Prudhoe Bay to ARCO. Then, in January 1995, Amerada Hess sold its 81% interest in the Northstar field to BP. One year later, Amerada Hess sold its small producing interest in Prudhoe Bay to BP. During this period, Amerada Hess also transferred many of its leases west of Kuparuk to ARCO. By the time ARCO announced its Alpine discovery in October 1996, Amerada Hess, an original owner of the lease on which the Alpine discovery was made, was no longer active on the North Slope.
- Additionally, since 1993, four of the nation's six largest oil companies have sold or traded all or parts of their North Slope interests to major TAPS owners ARCO or BP.

The firms checking out weren't the unlucky ones who hadn't hit oil. Nor were the departing firms footloose explorationists seeking better odds on another throw of the dice elsewhere. In several instances a large, vertically integrated oil company walked away from certified claims to billions of dollars of real oil. In a business where finding oil more economically than your competitors is one key to success, major oil companies were giving up oil already discovered, some of it just waiting to be pumped from fields already in production.

"How could a company not be interested in 140 million barrels flowing at 10,000 barrels a day 9 miles north of the largest field in North America?" the engineer in charge of field development for BP later wondered of Amerada-Hess. BP's representative thought Amerada Hess may have been frightened away by its estimates of field development costs which were much higher than BP's, for reasons that are not readily apparent.

Conoco's chief executive has offered a different reason why his firm left the North Slope. In an August 1996 interview with the trade journal *Hart's Oil and Gas Investor*, Conoco President and CEO Archie Dunham said it was high pipeline tariffs that had driven Conoco from Alaska. "It broke my heart to trade Milne Point," Dunham told the *Investor*, "but we had to do it. All the value of that property was taken away from us in the pipeline tariffs. It was a valuable strategic lesson — just look at why the producers in the Caspian Sea are so worried."

Could the major TAPS owners be using their control of the shipping link from the North Slope to drive out their competitors? In theory, at least, that would be illegal. The very reason that pipelines are regulated is to ensure that all parties have open access to the pipeline, and that their shipping charges are equitable and reasonable. But a broad range of informed studies — such as the study that quantified losses to the Alaska General Fund, the Alaska Permanent Fund and the windfall to the TAPS Owners of the generous dismantling charge provision of the TAPS tariff — have questioned the efficacy of pipeline regulation in general and the governance of TAPS in particular. Some of these critical analyses will be discussed in later chapters of this report.

Government and industry officials offer a standard explanation for the difficulties experienced by the departing companies. As the Governor's State Oil and Gas Policy Council February 1996 report noted, "due to the remote location of most oil and gas discoveries in Alaska, the minimum economic size for a petroleum discovery is significantly larger than in other areas of the world." This review does not challenge that observation. Rather, this report assumes the pattern of North Slope development is determined by the interaction of multiple causes. The vagaries of oil economics — vast crude reserves in the Middle East and elsewhere, relatively low world oil prices and uncertainty, to name a few — are frequently used to explain why some companies do not prosper in Alaska's oil patch. Again, there is truth to this observation.

None of these explanations rule out the possibility — strongly suggested by the evidence presented in this report — that the major TAPS Owners may employ high pipeline tariffs and/or discriminatory practices to force their competitors off the North Slope. The recent involvement of companies such as Anadarko and Union Texas Petroleum in new North Slope fields is tempered by the fact that these firms typically hold minority interests in property that is controlled by major TAPS Owners ARCO and BP. Moreover, these firms are typically much smaller than the firms they are replacing on the North Slope and are therefore less able to generate the hefty capital investment necessary to continued development of this remote, frontier province.

Optimum North Slope development for the benefit of all Alaskans requires further efforts to confirm and resolve problems that may be driving major oil companies from the North Slope. The history of oil pipelines, informed criticisms of the TAPS tariff structure and the troubling but little-reported pattern of North Slope property sales and swaps in recent years converge to underscore the importance of this report's two recommendations:

- Recommendation #1. To ensure that future policies regarding the economics of TAPS are well conceived and properly executed, the State should convene an independent tribunal to conduct an impartial and vigorous examination of its management of pipeline tariff and related regulatory issues.
- Recommendation #2. To ensure that the State's handling of TAPS-related issues contributes to the goal of maximizing resource development by assuring a level playing field for all competitors, Oilwatch Alaska should encourage the State and affected private parties — including individual citizens — to consider antitrust action against one or more of the major TAPS owners. Due to possible statute of limitations problems on State antitrust claims, immediate action in this regard is recommended.

The following possible actions beneficial to future North Slope development might result from these efforts:

- the State and the industry might cooperatively agree to alter the TSM to correct defects in the TSM tariff structure that appear to have penalized small producers;
- the State's efforts might trigger a collateral antitrust investigation by Justice Department.

Additionally, the results of this examination might provide a framework for considering whether the State needs to alter the structure by which it manages oil and gas issues. Possible changes that might enable the State to grapple better with the difficult problems managing development of the nation's largest oil fields for the benefit of all Alaskans include:

- establishing a Special Assistant to the Governor for Oil and Gas in the Office of the Governor;
- moving TAPS tariff management from the Department of Law to a line agency; and

- establishing a permanent commission with full investigative powers to review and examine North Slope oil transactions to ensure that pipeline and other antitrust abuses do not continue to inhibit North Slope development.

Whether or not a legal challenge to alleged antitrust violations on the North Slope can be mounted successfully, the facts and analysis presented here call into question whether the public is well served when a very small number of firms wield a high degree of control over the resource on which Alaska depends. The oil industry's expensive advertising campaigns on television and its lavish lobbying efforts in Juneau provide additional insight into the degree to which this industry has come to dominate Alaska's political climate. From a broad policy standpoint, the oil industry's apparent political hegemony over Alaska also deserves serious attention. But the primary issue addressed by this report is the role of TAPS in inhibiting Alaskan oil development by companies other than the major owners of the pipeline.

Although the information presented in this report calls for immediate and vigorous review of the oil policies the State of Alaska has pursued on behalf of its citizens, one can envision other possible responses to this analysis: For example, State policy makers can continue to ignore the possibility that TAPS is being used to strangle competition on the North Slope. That would be unfortunate. By taking no action on these recommendations, the stewards of Alaska's resources would be gambling. Their wager would be that the future will be kind enough to cause oil prices to rise sufficiently to mask the effects of any State failures in this important area. In view of the congruence between the historical background laid out in this report and the departures of major oil companies from the North Slope, it would be foolhardy to take this gamble. It may have broken the heart of Conoco's CEO that "all of the value of that property [Milne Point] was taken away in pipeline tariffs." But the real losers when Conoco left Alaska were the people of Alaska, whose State General Fund and Permanent Fund depend heavily on resources managed to maximize revenue by ensuring open competition on a level playing field.

BACKBONE

Standing Up For **Alaska's** Future

Christy McGraw, Director

STATEMENT OF PURPOSE

BACKBONE formed to provide a statewide forum for all citizens of Alaska to:

- Express concerns and opinions;
- Share information;
- Examine and gain a complete understanding of the implications and consequences; and,
- Develop common strategies and goals, in connection with the impending takeover of ARCO by British Petroleum.

BACKBONE seeks to represent, assert, and advance the interests, traditions, rights, and expectations of all the people of Alaska in connection with the pending takeover of ARCO by British Petroleum.

BACKBONE seeks to preserve, defend, and assure an independent and thriving economic, social, environmental and political climate in Alaska.

BACKBONE seeks to actively, aggressively, and positively influence the future and fate of Alaska.

Standing Up For **Alaska's** Future

Christy McGraw, Director

Testimony on Proposed Takeover of ARCO by British Petroleum

Prepared for

**Alaska State Legislature Joint Special Committee
On Mergers
June 11, 1999**

BACKBONE is a fast growing group of concerned Alaskans representing many organizations, interest groups, political viewpoints and individuals from across the state. We have come together because we are gravely concerned about the long-term implications of the pending takeover of ARCO by BP Amoco.

This takeover is perhaps the most important economic event since the construction of the Trans Alaska Pipeline System, and when viewed in all aspects, may be Alaska's single most momentous event since statehood. Our over arching concern is the unprecedented concentration of economic and political power and control this takeover will create over our state's vital oil and gas resources, and our future economic viability as an independent state.

Because this moment is so critical to Alaska's future, we wrote you two weeks ago to ask that you do everything within your power to ensure the widest possible public education and meaningful participation in the decision making process at hand. Additionally, we ask that you create the most thorough public examination of this merger that is humanly and governmentally possible.

As you know, **BACKBONE** has identified 9 areas of concern. These Include the following:

- Optimize marine transportation with emphasis on responsibility, safety and economic return to Alaskans.
- Optimize operation of the Trans Alaska Pipeline System (TAPS) with emphasis on providing the open, commercial access to potential producers that is essential to ensuring competition that will produce the greatest return to Alaskans.
- Maximize competition, environmental protection and return to Alaskans in the development of current and new North Slope facilities and fields by ensuring fair access to all potential producers.
- Ensure access to, and production and marketing of, North Slope natural gas under terms that will provide a substantial source of revenue for the state's budget for years to come.
- Ensure that the leasing of acreage for oil and gas development including leases currently held and those offered for future sales provides for maximum return to Alaskans on a timely, state dictated, basis.

In addition to considering these six points in their total context, there are three other matters, which should immediately be added to this list. The first is the non-existent TAPS DR&R fund. BACKBONE would like to see you encourage the Governor to use merger discussions to correct industry's over-collection of these funds and require escrow of the necessary amounts in an account that benefits Alaskans. This and other problems associated with TAPS tariffs must be carefully reviewed during takeover deliberations.

The second concern is the impact of the now-overshadowed Exxon/Mobil merger. BACKBONE asks that you, again, encourage the Governor to intervene and demand access, production, and marketing of North Slope natural gas as a condition of this merger approval.

Additionally, BACKBONE thinks you must conduct a thorough examination of the impacts of the takeover on the social, cultural, economic, political, and environmental foundations for Alaskans' quality of life. Of particular interest to BACKBONE members from the labor community is the issue of Alaska hire. BACKBONE does not want the Legislature or the Governor to gloss over the importance of 100% Alaska hire, job security, wage security and the spin off effects one oil company with a large support industry can have on the our major concerns, but also on the small businesses and materials/procurement industry within the state. We do not want to see many small, currently prosperous small businesses squeezed out.

All Alaskans should be aware of the ramifications of the political and economic power British Petroleum will have if this takeover is allowed to proceed in its present state.

We thank you for this first step in opening the process to Alaskans for their review and input. We ask that you continue this path of openness and provide those reports and analysis you obtain from the experts you have hired to the public for comment and discussion, and take the counsel of all Alaskans when you make your recommendations to the Governor.

**Alaska Support Industry Alliance
Testimony on the BP Amoco – ARCO merger
before the
Special Joint Committee on Mergers
June 11, 1999**

by Karen Cowart, General Manager

Thank you Mr. Chairman & Committee members

My name is Karen Cowart, General Manager for the Alaska Support Industry Alliance. The Alliance membership includes nearly 350 businesses that contract directly with producer companies to provide products and services in support of oil and gas activity. Our mission is to advocate safe and environmentally sound petroleum exploration, development and production for the benefit of all Alaskans.

Thank you for the opportunity to provide the oil and gas contractor community's perspective on the BP Amoco – ARCO merger. I will not comment on royalties and taxes. We believe these issues are best addressed by the state. I will talk about the concerns that the support industry has with regard to the competitive downsizing to one major operator/producer and what that means in terms of contracts and jobs.

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

Our Concerns

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

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

Alliance members are also concerned that the number of support industry contracts will shrink with the advent of one major operator. Initially, we expect to see further job losses in the support sector as administrative functions are consolidated. Support industry businesses will likely respond to demand changes by streamlining their own operations, and perhaps negotiating their own mergers and consolidations.

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

Long Term Optimism

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

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

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

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

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

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

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

The Status Quo Won't work

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

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

The Alliance appreciates the opportunity to voice our opinion on the merger and its effect it may have on our industry.

Thank you for your attention and I'll be happy to address specific questions you may have.

TESTIMONY
REGARDING: BP AMOCO – ARCO MERGER

June 11, 1999

1:00 p.m.

Good Afternoon. Thank you Mister Chairman and members of the committee.

My name is Mary E. Shields. I am General Manager for Northwest Technical Services in Anchorage, Alaska. As an employee support provider, NWTs employs between 120 – 150 people, many of whom work directly with the oil industry. We hold contracts with BP Amoco and with ARCO Alaska, Inc. and greatly value our relationship with both companies.

Like many people in Alaska, I watched the oil prices slide down the slippery slope last fall. I paid close attention to what was happening in the world of mergers and felt that at some point, unless there was a dramatic turn-around in prices coupled with the opening of the Coastal Plain, something was going to have to change. We all knew that the status quo was not going to work. Efficiencies needed to be realized for our Alaskan operators to continue to compete in a global market. As we all know, this state of affairs contributed to the BP Amoco merger that is now followed by the ARCO transaction.

Do I hate to see this happen? Of course I do. I would be lying if I said otherwise. I have a high regard for the people in both of these companies – I have worked closely with some of them for nearly 15 years. I don't want to lose any of them from the Alaskan community. However, do I understand the necessity of this action? Yes, I do. As stated, the status quo could not continue. Do I regret that BP Amoco is the one that made the purchase? No, I do not. BP has been involved in Alaska petroleum exploration and development since the beginning.

Most of its employees as well as the ARCO employees are long time residents of Alaska and have an understanding of Alaska's culture. They are committed to doing the job right – environmentally, safely and economically.

ARCO and BP Amoco have handled this transaction in a very straightforward fashion. Once the deal was made, the information was immediately conveyed to our Governor and state representatives. Further, a special meeting with the Alaska Support Industry Alliance was held on Friday, April 9th. This was not just a meeting, but an open microphone forum where Richard Campbell of BP Amoco and Kevin Meyers of ARCO Alaska, Inc. answered any and all questions put before them – no screening; no hedging. Over 400 Alliance and other community members attended. Since then, several other such meetings have been held to assure that all questions have been answered.

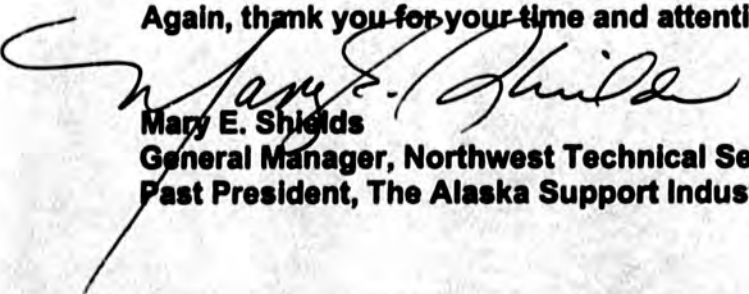
As the manager of a Contract Employee firm, I am concerned about the numbers of people who will be let go. I am concerned about the status of our contracts and how competition will be established as things move forward. These are decisions that will effect the health of NWTs as well as the health of other firms. BP Amoco and ARCO addressed those concerns, both in the newspaper, at The Alliance breakfast and in other forums.

As a citizen of Alaska, I am always concerned for the health of our economy. What will be the impact – not only on the lease sales, but also on contributions to charitable and arts organizations? We have relied heavily upon BP and ARCO for their support over the past 20+ years. I am pleased and encouraged to know that that support will continue.

I echo other Alaskan business leaders in looking to the newly structured company to continue its emphasis on Alaskan hire and Alaskan buy. It is now critically important.

As a member of the Alaskan community – both business and social – I applaud both the Governor's and the Legislature's teams as they continue to analyze the change in business climate that will result from the uniting of two of our biggest employers. This is good stewardship and I expect nothing less from these two branches of government.

Again, thank you for your time and attention.



**Mary E. Shields
General Manager, Northwest Technical Services
Past President, The Alaska Support Industry Alliance**

HAWK CONSTRUCTION CONSULTANTS, INC.
Testimony on the BP Amoco - ARCO merger
June 11, 1999

By Maynard V. Tapp – President
Hawk Construction Consultants, Inc.

Thank-you Senator Halford.

My name is Maynard Tapp - President of Hawk Construction Consultants, Inc. and a member of the Alaska Support Industry Alliance. In this hearing I do not speak for the Alliance but as one of its concerned members and as a citizen of the State of Alaska.

The key points for my company are as follows:-

- Alaska must remain competitive in the world wide oil market for my company to have the chance to continue in business here in Alaska.
- We recognize that changes in the oil industry in Alaska were inevitable. I have worked in similar circumstances outside of Alaska, and felt it was only a matter of time until the North Slope is operated by one company.
- The "one company" scenario is somewhat frightening only because we are unfamiliar with its operation. Hopefully, this scenario will offer competitive opportunities for all Alaskan suppliers and contractors.
- BP- Amoco - ARCO have been good citizens of the state in the past and I believe they will in the future. Their announcement regarding higher capital expenditures for the next five years as well as effort towards commercialization of North Slope Gas are good indicators. Also ~~they~~ support ~~of~~ the ongoing work being performed by the ARCO sponsored LNG task force
- Consolidation of their operations here in Alaska may be unpleasant for people in their organizations. It is also painful and uncertain for us in the support industry community. However, we have found ways to survive and continue in Alaska. The whole world economy is changing to an economy based on the ability to manage and respond to change.
- I hope Alaska can maintain its "brain trust" developed in the oil companies and the support industry over the years. There is tremendous talent here and I would hate to see it go away.
- The State of Alaska needs to maintain vigilance protecting the people and natural resource wealth of the state. This includes understanding the future as well as helping develop the vision and environment that encourages responsible resource development.

Thank-you and good afternoon.



June 11, 1999

To: The Joint Special Committee on Mergers
Senator Rick Halford, Chairman
Alaska State Legislature

From: Howard "Buzz" Otis, President
Great Northwest Inc.

Good day! I would like to take this opportunity to comment on the acquisition of ARCO by BP Amoco. My firm, which specializes in civil construction, is based in Fairbanks, where we have operated out of for the past twenty-three years. Our work is normally done in the geographic area of Denali Park to the west, Valdez to the south, Tok to the east, and the North Slope. Last year we formed a limited liability company between Great Northwest Inc. and Houston Contracting Co., to perform pipe and steel fabrication work, as well as truckable module construction in the Fairbanks community. We were successful last winter in constructing all the vertical support members for ARCO Alaska's Alpine pipeline as well as the module piles for the Alpine buildings.

As you can imagine, the BP Amoco announcement that announced they would be purchasing ARCO came as a big surprise to me, as it was for many Alaskans. Prior to the announcement it had become obvious to me that ARCO had become a prime candidate for acquisition or merger, the big questions were who and when. After the initial surprise and after having time to think rationally about the acquisition it becomes obvious to me that combining these two companies will make Alaska's oil more competitive because it will allow oil to be produced at a more competitive price. By reducing the cost of producing the oil it should theoretically free up more capital to spend on exploration and development.

I believe that the acquisition will be good for Fairbanks and Great Northwest Inc. or Great Northwest / Houston LLC for the following reasons:

BP Exploration/Alaska has been committed to placing more oil industry related work in Fairbanks. If not for the unnecessary court delays on the North Star Project, much of the work that Fairbanks will be doing for North Star would have been completed. This work consists of vertical support member and module pile fabrication, insulating pipe, valve blanket fabrication, and possibly module construction.

With the commitment to spend a billion dollars a year over the next five years on North Slope development I believe Fairbanks will have significant opportunities to participate in the exploration, design, and development of new fields as well as the enhancement of existing fields.

BP has a strong history of involvement supporting non-profits in Fairbanks. The commitment by BP to not only honor BP's and ARCO's past support, but to actually increase the level of that support will help the many people who rely on the help of the non-profits. This will help improve the quality of life here in Fairbanks.

Jun-11-99 01:21P

JUN-11-99 FRI 11:50 AM GREAT NORTHWEST INC

FAX NO. 907 456 7779

P. 03 P.03

Thank you for your efforts in working this critical issue on the behalf of the citizens of Alaska, if you have any questions or I can be of assistance to you as you wind your way through this process, please feel free to call me at (907) 452-5617.



ALASKA STATE LEGISLATURE

Please enter into the record my testimony to the Joint Special Committee on Mergers
Committee on BP Amoco/ARCO Merger Committee Name Dated 6-11-99
Bill / Subject

Organized labor thinks there is great opportunity in the BP Amoco/ARCO merger. We feel because of the merger more capital investments into capital projects will occur, benefiting Alaskan workers. B.P. Amoco has committed to invest 5 billion dollars in North Slope development over the next five years. We feel that this kind of investment would not have happen without the merger. Saying that, it is normal human behavior to feel uncomfortable not knowing how the merger will effect our future. We anticipate that BP Amoco will continue to aggressively explore and develop new oil fields on the North Slope. We would also expect them to put into production the National Petroleum Reserve, so production doesn't decline any further than it is now in the Trans-Alaska Pipeline.

Economically, Alaska and it's workers need this continued investment from the oil industry. When the industry is investing in projects Alaskans are working. Oil industry jobs have provided the needed employment for Fairbanks workers and from all over the state to support their families. Workers from all over the state applaud this 5 billion dollar investment in North Slope development now that BP Amoco will have the expertise and financial resources to ensure a long and successful future for Alaskan workers working in the oil industry.

Thank you all on committee.

SIGNED:

Jim Plaquer - Business Agent Local 302
Testifier

International Union of Operating Engineers Local 302
Representing

819 1st Ave, FBKS, AK. 452-8131 Ext #230
Address / Phone Number

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DON DOKKEN
President

**FAIRBANKS BUILDING
& CONSTRUCTION TRADES COUNCIL
AFL-CIO**

90 Hall Street
Fairbanks, Alaska 99701
(907) 456-4246
(907) 457-3864

June 3, 1999



JAY QUAKENBUSH
Secretary/Treasurer

Robert A. Georgine
President
National Building and Construction Trades Department
1155 Fifteenth St., N. W. 4th Floor
Washington, D. C. 20005-2707

Dear Sir and Brother:

At our May 28th meeting, The Fairbanks Building and Construction Trades Council discussed the BP Amoco purchase of ARCO. With out a doubt, this acquisition will create many pros and cons for everyone at stake.

It is the view of the Fairbanks Building and Construction Trades Council that the acquisition will be beneficial to Organized Labor, specifically the Construction Trades. The new enterprise will gain efficiencies by combining the strengths of two companies, enabling BP Amoco to attract more investment dollars to Alaska creating construction projects our members sorely need. As described in an open letter to all Alaskans signed by Richard Campbell, BP President, and Kevin Meyers, ARCO President:

- BP Amoco will invest 5 billion dollars in North Slope development over the next five years;
- BP will continue the ARCO-led gas sponsor group, relocate their gas technology center to Alaska, and build a gas-to-liquids pilot plant on the North Slope;
- Organized labor will continue to play an important role in BP Amoco's North Slope construction activities;

Even though the Fairbanks Building and Construction Trades does not have a guarantee of the above listed work opportunities we do feel the potential is there. In an unanimous vote of the Building Trades Crafts we support the BP acquisition of ARCO. We also respectfully request that you support this important change in Alaska's oil industry.

Sincerely,

Don Dokken
Don Dokken
President

cc: Richard Campbell
Kevin Meyers



ALASKA STATE LEGISLATURE

Please enter into the record my testimony to the Joint Spec. Com. on Mergers
Committee on BP/ARCO merger Committee Name
Bill / Subject Dated 6-11-99

The Northern Alaska Environmental Center and the 1300 members we represent fully believe that the merger between BP and ARCO will undoubtedly result in major environmental implications, mainly because of the consolidation of power. 3/4 of Alaska's roads, pipelines and drilling sites will be controlled by one massive company with a unified and unchallenged voice in both the state and the government. Alaska's environment has already suffered greatly because of the impacts of oil on the land and the people. Further risks cannot afford to be taken. This state has a ~~very~~ unique fragile environment along the north slope, characterized by musk ox, spotted eagles, caribou herds and other precious wild life rarely found anywhere else in the world. The protection of these lands is vital to the strength and character of Alaska, which oil companies and this merger in particular, greatly threaten.

Thanks for your time.

SIGNED:

Ashley Buntz

Testifier

Northern Alaska Environmental Center

Representing

218 Driveway St. Fairbanks AK 99701

Address / Phone Number



ALASKA STATE LEGISLATURE

Please enter into the record my testimony to the

~~Joint Special Committee~~

Committee on

Mergers

Dated

Committee Name

Bill / Subject

I am with Yukon River tours. We operate on the Yukon River in Stevens Village's Ancestral Lands. We need the RED system protected as visitors want unspoiled scenery. Promises were made by the oil industry when they first began coming through Stevens Village's ancestral lands. Those promises have not been kept. We need things all squared away before we can confidently not oppose this merger.

SIGNED:

Testifier

Yukon River tours

Representing

452 7162

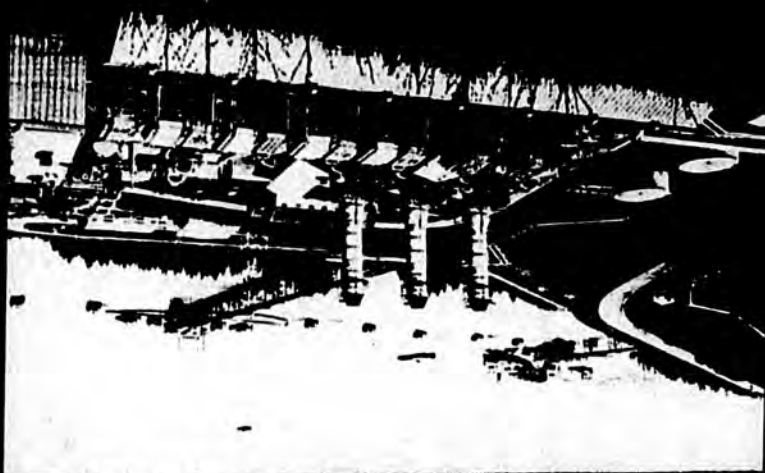
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Annual Report
1998



The Joint Pipeline Office

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Completion of this report fulfills annual reporting requirements. The State of Alaska Administrative Order 134 requires the State Pipeline Coordinator to submit an annual progress report to the Governor. Section 28 of the Federal Mineral Leasing Act requires the Secretary of Interior to submit an annual report to the House and Senate Committees of Interior and Insular Affairs.



June 1999

Letter to Readers:

The Joint Pipeline Office (JPO) implemented a new work plan in 1998 to identify and measure work outputs and to tie costs to those work outputs for budgetary purposes. The work plan added more substance to the existing Comprehensive Monitoring Program (CMP) by including a wider range of products with specific deliverable time tables in quarterly increments. This annual report provides the reader a step by step review of JPO accomplishments as outlined in the work plan.

There are a few items of interest we would like to specifically bring to your attention.

CMP Consolidation: The CMP used twelve focus areas to evaluate overall Trans-Alaska Pipeline System (TAPS) performance in 1998. JPO has consolidated these 12 areas to four: Culture, Maintenance, Construction, and Operations. Original CMP focus areas such as Environment, Safety, Quality, Project Performance, Project Design, and Configuration Management will be incorporated into the four areas. The upcoming Risk Management CMP Report will be the last published under the 1998 work plan which used the original focus areas.

Alaska Native Utilization Agreement: This year the Alaska Native Utilization Agreement was renewed by the Department of Interior and Alyeska with some interesting improvements. In particular, a "Gateway" or process Alyeska will use to assist qualified Alaska Native employees and trainees in finding oil and gas industry work when an Alyeska position cannot be found. Other improvements are expansion of coverage to more TAPS contractors and subcontractors and linkage of scholarship expenditures directly to TAPS or other oil and gas industry jobs. We believe Alyeska is administering this program very well and we congratulate them on a job well done.

Audit Action Items (AAIs): We are happy to report that of the original 4,920 audit action items, only five remain open. It has taken Alyeska a long time to resolve all of these items which JPO has verified for closure. Revisiting audit action items is a major function included in the CMP to ensure that the items are not recurring.

TAPS Oil Spill Response Plan: The TAPS Oil Spill Response Plan was renewed in 1998 after completing major revisions to the plan which resulted from dramatic changes to TAPS. Oil flow has reduced to around 1.2 million barrels, operation of four of the eleven pump stations has been shut down in the last two years, and Alyeska has changed from an Anchorage-based organization to one centered in Valdez and Fairbanks.

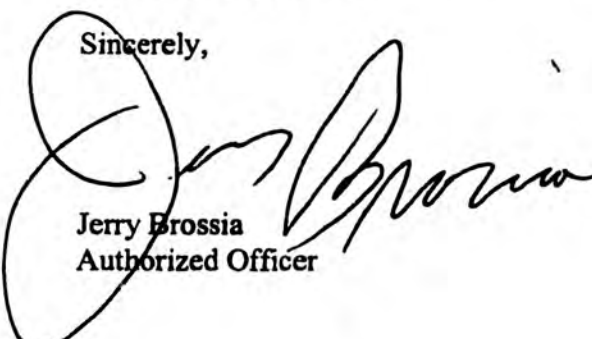
Employee concerns: JPO's objective is to achieve a work culture that does not hinder TAPS workers from reporting concerns about pipeline integrity, safety, or environmental protection for fear of harassment, intimidation, or reprisal. This objective has not been achieved. JPO acknowledges that Alyeska has expended considerable effort in improving their work place culture. However, the results of employee surveys conducted by JPO and Alyeska within the past year have not reflected success with this effort. Many factors contribute to this continuing problem: 1) past Alyeska missteps in concern handling, 2) delays in bringing concerns to closure, 3) Alyeska's reorganization and downsizing, and 4) employee apprehensions about future cost-cutting. Because of these continuing concerns, JPO's employee concerns group will have two additional staff in 1999 to identify root causes of problems as they relate to environment, safety, and integrity issues, and to incorporate those trends into JPO's Comprehensive Monitoring Program.

North Slope Pipelines: The State Pipeline Coordinator's Office continues to process rights-of-way applications for several proposed North Slope pipelines. Due to the extremely low price of crude oil during past months, some current projects will be affected by the prices.

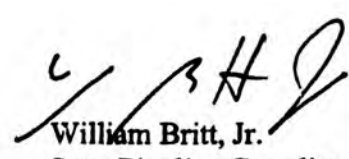
Long-range Planning: In addition to the challenges facing us in 1999, our long range planning challenges to be accomplished by year end of 2003 include Grant and Lease renewal. The consolidated CMP process will be applied to 1) document JPO's efforts to verify compliance with the Grant and Lease, 2) evaluate condition and safety of critical TAPS systems, and 3) demonstrate that TAPS culture allows free and open reporting of problems without harassment or intimidation of employees.

Thank you for taking the time to look through our annual report. If you have any questions or would like to have copies of any reports referenced herein, please call Rhea DoBosh, Public Affairs (907) 271-4338.

Sincerely,



Jerry Brosia
Authorized Officer



William Britt, Jr.
State Pipeline Coordinator

Joint Pipeline Office 1998 Work Plan.

In 1998 JPO implemented a work plan outlining and scheduling commitments for the year in quarterly increments. Most of these commitments stem from the 1998 goals identified in last year's annual report including implementation of a work plan. The work plan included staff responsibilities and agency deliverables and considered responsiveness to unscheduled events and responding to the concerns of stakeholders. JPO's 10 major 1998 commitments follow:

1. Publish six CMP Reports and complete assessments in other CMP areas.
2. Complete the staff work necessary for the renewal of the Alaska Native Utilization Agreement.
3. Evaluate and revise the Oil Spill Response Plan to provide for timely oil spill response capability for TAPS.
4. Issue the required permits and authorizations to Alyeska to operate and maintain TAPS.
5. Monitor high-risk projects and activities to ensure that pipeline integrity, environmental protection, and public safety are achieved and maintained on TAPS.
6. Oversee Alyeska's employee concern case handling to assess whether concerns are being resolved and the harassment culture is being eliminated. Repeat 1997 survey of workers.
7. Verify closure of remaining open audit action items.
8. Develop the first phase of a TAPS geographic information system (GIS).
9. Secure permanent JPO offices and adopt an electronic records and mail distribution system.
10. Work with Alyeska to enhance oil leak detection.

JPO met these 1998 work plan objectives and delivered most products within planned time frames. Continuing goals include working with Alyeska to enhance oil leak detection; issuing the required permits and authorizations to Alyeska to operate and maintain TAPS; monitoring high-risk projects and activities; and conducting the Employee Concerns Program surveys annually well into the future. JPO accomplishments and the status of JPO's 10 major commitments for 1998 are documented in this annual report.

Commitment 1.

Publish six CMP Reports and complete assessments in other CMP areas.

JPO Comprehensive Monitoring Program

To date, JPO has released seven Comprehensive Monitoring Program Reports. Two CMP reports covering Alaska Native Utilization and Employee Concerns were released in 1997. Environmental, Safety, and Project Performance CMP reports were released in 1998 and Maintenance and Operations in 1999. The Risk Management CMP report should be released in the summer of July 1999.

Some of the issues incorporated into the Project Performance, Operations, and Maintenance CMP reports belong as much to other CMP focus areas of Configuration Management and Quality as the topic reported. As the later CMP reports became broader, the concept of 12 discrete reports made less sense. In fact, the originally planned 1999 Configuration Management CMP report would have been little more than a repeat of the change management findings contained prior CMP reports. After Risk Management, the CMP and subsequent reports will be consolidated into four summary areas:

Original CMP Focus Areas		Consolidated Focus Areas
<i>Maintenance</i> <i>Quality</i> <i>Safety</i> <i>Environment</i> <i>Project Performance</i> <i>Operations</i> <i>Configuration Management</i>	Risk Management Project Design <i>Native Employment and Training</i> (Section 29 of the Grant) <i>Employee Concerns Program</i> Equal Employment Opportunity (Section 28 of the Grant)	Culture (Section 29, Section 28 and employee concerns) Maintenance Operations Construction (project design and project performance) <i>Safety, environment, configuration management and quality will be incorporated in Maintenance, Operations and Construction</i>
<i>Italics indicate published CMP reports</i>		

Executive summaries of the seven published reports follow the next section on CMP background. Beyond the executive summaries, considerable CMP monitoring was done in the area of corrosion, Valdez Marine Terminal Tanker Vapor Control operations and maintenance, and the valve repair/replacement project. These activities are summarized later in this report (Commitment 5).

Background on the CMP

JPO's approach to monitoring Alyeska activities and the way it conducts its' business with Alyeska is referred to as compliance partnership. This involves clearly defining objectives, frequent communication, proactive problem resolution, and a "no surprises" approach to achieve

JPO objectives. The CMP process was explained in detail in last year's annual report, however, a brief summary is provided below.

CMP Process: The CMP is a layered or three-tiered approach to oversight. Surveillances comprise the first tier or level where the most basic monitoring occurs by verifying compliance with Grant and Lease Stipulations and Alyeska's established procedures for specific TAPS activities. A checklist is produced in advance of the activity to cover all necessary attributes of that activity. For example, a checklist is developed for material sites. There are 76 active material sites along the TAPS corridor and all are monitored annually, therefore, there would be one surveillance conducted at each site. This information, in addition to other surveillances conducted on the same focus area, would provide the basis for capturing trends and a foundation for an assessment which is tier two of the CMP.

Tier two involves capturing trends and identifying findings from related JPO surveillances and engineering reports through assessments. Assessments are the primary tool used to issue findings to Alyeska for corrective action. These reports are more technical in nature and are designed primarily to communicate findings to Alyeska.

CMP Reports make up tier three. Assessments findings are included as well as Alyeska's responses to findings, trends, and conditions. These reports are designed for stakeholders as they provide a bigger and more informative picture of a particular focus area.

7 Published CMP Executive Summaries

EMPLOYEE CONCERNS CMP Executive Summary

March 1997

The Management Evaluation Team thanks the Alyeska Pipeline Service Company (APSC) and the Joint Pipeline Office (JPO) for their hospitality and professional cooperation throughout the conduct of the APSC's Employee Concerns Program evaluation. During site visits the team received outstanding safety and orientation briefings and was made welcome by facility managers and employees. Personnel were open and gave generously of their time to explain facility operations and provide input to the team. The APSC and JPO can be proud of the dedicated professionals within their respective organizations.

The APSC's Employee Concerns Program is a relatively young and developing program. The basic operating procedures documentation for the Employee Concerns Program is fundamentally sound. Several aspects of APSC's Employee Concerns Program implementation were identified where suggestions for improvement are provided. One key responsibility of the Employee Concerns Program, support to corporate culture change, was identified as needing priority attention. It is noteworthy that the Employee Concerns Program Manager recognizes this important function and has a sound vision for the future of APSC's corporate culture relative to employee concerns and the Employee Concerns Program's role in achieving the vision.

The APSC is commended for utilizing the corporate "Code of Conduct," policy statements, and oral communications to encourage employees to raise concerns and for emphasizing intolerance of intimidation, harassment, and retaliation. However, there is a need to emphasize consistent

actions to reinforce and validate these positive policies and priorities. Employees see actions as the true barometer of corporate leadership commitment to support concerned employees and ensure a positive work environment. Failure to "walk the talk" compromises the value of written policies and verbal endorsement by top management.

Improvement of corporate culture is the key to quality and the successful handling of concerns. Several basic recommendations are provided, which serve to facilitate positive cultural change. The ultimate goal is a corporate value system that values employees who raise concerns, is free of retaliation, and achieves quality improvement by involving all employees.

Although the JPO oversight and "800 Hotline" (hotline) program lack approved policy direction, the Management Evaluation Team believes the hotline is currently operating with the appropriate level of direct involvement by the JPO in the concerns process. Most employees properly recognize the hotline as a backup to resolving concerns through the management chain and APSC's Employee Concerns Program. It remains for JPO to establish operating procedures and clearly define expectations for both its direct role in employee concerns and its oversight responsibility regarding APSC's Employee Concerns Program.

ALASKA NATIVE UTILIZATION Executive Summary

September 1997

The 1974 Federal Grant of Right-of-Way contains a provision (Section 29) requiring the Trans-Alaska Pipeline System (TAPS) permittees to enter into an Agreement with the Secretary of Interior "...regarding recruitment, testing, training, placement, employment, and job counseling of Alaska Natives." This was designed to secure full participation by Alaska Natives in Alaska's burgeoning oil and gas industry. This Agreement helped secure a route for the pipeline unencumbered by Alaska Native land selections.

The Plan of Action approved by the Department of Interior required Alyeska to provide 3,500 training or employment opportunities to Alaska Natives during the TAPS construction period. Alyeska further committed that a minimum of 2,470 individual Alaska Natives would be utilized in fulfilling the overall 3,500 training or employment opportunities.

During the operational phase of the pipeline, Alyeska stated that their objective was to train and employ Alaska Natives so that within two years of start-up Alaska Natives would occupy a percentage of jobs at least equivalent to their proportionate share of the total population of the State of Alaska. That percentage was then estimated to be 20 percent. That Plan of Action was subsequently revised by Alyeska in 1976 to reduce the Alaska Native employment goal to 16 percent, however, this revision was never approved by the Department of Interior.

Over 5,770 individual Alaska Natives were ultimately hired to work on TAPS during construction. These individuals worked on 15,047 different jobs. In the years following construction from 1978 through 1994, Alaska Native employment on TAPS slipped to less than five percent.

On October 20, 1995 Alyeska Pipeline Service Company and the U.S. Department of Interior signed an agreement designed to remedy past under-employment of Alaska Natives on the Trans-Alaska Pipeline System. The Agreement calls for specific actions by Alyeska and its contractors to enhance training, education, employment and related activities to increase the number of Alaska Natives able to more fully participate in TAPS-related employment in Alaska.

On September 30, 1997 the Joint Pipeline Office (JPO) completed an audit of the Alyeska Pipeline Service Company Section 29 Program. The audit was conducted to determine if Alyeska's Program is in compliance with the October 1995 Agreement and to assess its effectiveness in achieving the goals and intent of the Agreement. The audit also identifies potential measures to improve Alyeska's performance related to Alaska Native training and hiring.

The results of JPO's evaluation provides an early assessment of Alyeska's progress and will serve as a baseline against which future efforts by Alyeska and its contractors can be compared. The audit was conducted now so that issues or concerns of importance could be identified by the JPO and acted upon by Alyeska before December 1998, the end of the first formal three-year review period described in the Agreement.

The audit yielded 42 Findings which indicate compliance or require corrective action by Alyeska. Most of the Findings relate to areas which could be improved. Major Findings include:

- Alyeska is in compliance with the major terms of the Agreement. Overall Alyeska leadership and management policies have markedly changed to reflect acceptance of the Section 29 commitments in the Federal Grant.
- Alaska Native hiring during the current Alyeska reorganization reflects a strong commitment by current Alyeska leadership to the goals of the program. By the second quarter of this year, Alaska Native employment in every job category (except Technician) had increased, in the face of down-sizing efforts. However, Alyeska's goal of 20 percent Native participation by the year 2004 will require nearly tripling the current number of 68 Alaska Native employees.
- Alaska Natives are employed at all levels of Alyeska (not so for the Contractors), but are under-represented in the manager/supervisor, professional and technician job categories.
- There are inconsistencies in accounting for expenditures chargeable to the Section 29 Program and in reporting status of progress.
- Mentoring and cross-cultural awareness programs have not yet been put into place.

- Most Designated Contractors are working diligently to meet their employment goals and some (for example Doyon Universal Services and Tatitlek Chugach Corporation) have exceeded Alaska Native hire goals. Successful approaches used include alliances and partnerships with unions, training facilities, oil and gas industry firms, Native Corporations and non-profit organizations.
- Two contractors (Crowley Marine and Tidewater) are not currently required by Alyeska to participate in the Section 29 Program. JPO believes these companies are subject to the Agreement.
- There is a need for clearer Section 29 Program rules to guide both Alyeska internally and its contractors.

Among the audit **Recommendations** for improvement are:

- Alyeska should expand the Internship program and add other entry-level or "gateway" employment opportunities, such as Apprenticeships and Co-op Student programs.
- To ensure fair treatment, Alyeska and the Designated Contractors should establish consistent procedures for routinely verifying Alaska Native tribal enrollment status claimed by job applicants.
- Alyeska should establish a clear link between scholarship funding and the expectation of future employment on TAPS or in Alaska's oil and gas industry.
- Alyeska should investigate vocation-education type opportunities for common job categories on TAPS.

The Audit Report provides a detailed account of the audit's background, scope and methodology, objectives, findings and recommendations. The audit is structured so that it parallels the structure of the 1995 Agreement.

ENVIRONMENTAL CMP Executive Summary

March 1998

The Joint Pipeline Office evaluated existing surveillance, assessment, and audit data to determine the status of Alyeska's TAPS Environmental Protection Program. JPO makes the following conclusions about Alyeska's environmental performance:

- **Alyeska is in compliance with environmental stipulations of the grant and lease based on 1997 performance.**

- **Alyeska is in compliance with most environmental laws and regulations.** Several noncompliance issues identified by agencies were unresolved during the period covered by this report.
- **Alyeska has implemented an adequate oil spill prevention, preparedness and response program.** Maintaining an adequate program while making organizational and operational changes in the company will require continued diligence by both JPO and Alyeska. Alyeska has submitted a revised oil discharge prevention and contingency plan (C-plan) which will be reviewed by JPO to ensure response capability and oil spill prevention.
- **Corrective and preventive actions** resulting from past audit findings related to the TAPS Environmental Protection Program **are in place and effective.**
- **JPO and Alyeska employee concern programs have benefitted TAPS environmental protection.** Approximately 12.5% of the environmental concerns were validated by JPO or Alyeska and resulted in corrective action by Alyeska.
- **The effectiveness of Alyeska's environmental policy,** which communicates the corporate commitment to environmental protection to all Alyeska employees and contractors **could be increased** by clearly stating it in a high level document signed by Alyeska's top management.
- **Alyeska has implemented an effective program of environmental audits and environmental surveillances.** However, opportunities for improvement exist.
- **Alyeska conducted major maintenance projects in a manner that minimized risk to the environment.**

In addition, the JPO has documented concerns related to the potential for increased risk to the environment posed by Alyeska's recent reorganization. JPO cannot yet determine if potential risks are occurring because Alyeska is still in transition to the new organization. JPO plans to assess if consequences or events associated with potential risks actually occur after Alyeska's new organization is in place in mid-1998.

In 1998, JPO will continue to oversee Alyeska's TAPS environmental protection program, including compliance with environmental stipulations of the grant and lease.

SAFETY CMP Executive Summary

April 1998

The Joint Pipeline Office evaluated surveillances and assessments conducted by JPO, employee concerns investigated by JPO, the BLM audit conducted by QTC, Inc., and the TAPS Assessment Audit to determine the status of Alyeska's employee safety program. Considering a certain amount of risk exists in any work environment, JPO formed these conclusions:

- **Alyeska is generally in compliance with grant and lease stipulations 1.17, Fire Prevention and Suppression and 1.20, Health and Safety, based on 1996-1997 performance. Compliance with Stipulation 1.17 needs improvement.**
- **Alyeska has constructed buildings without approved plans from the State Fire Marshall.**
- **The fire detection and suppression systems in the pump station and Valdez Marine Terminal processing areas meet the requirements of the grant and lease.**
- **The Alyeska Corporate Safety Manual (SA-38) adequately addresses safety of the workers on TAPS equipment and facilities. Alyeska is in compliance with the requirements of SA-38, however, some sections could use improvement.**
- **Alyeska conducted major maintenance projects in a safe manner that minimized risk to workers. Alyeska and its contractors employ a competent safety staff to minimize accidents and mitigate risks.**
- **Alyeska makes a concentrated effort to identify and abate hazards.**
- **Supervisors investigate and report accidents in a proper and timely manner, obtaining assistance of Alyeska safety staff when necessary. Alyeska accident rates are lower than the national average.**
- **The number of employee concerns relating to worker safety have decreased. JPO investigates and resolves employee concerns as they surface.**
- **JPO surveillance indicates audit items relating to worker safety are not repeating.**

JPO concluded that Alyeska has made a good faith effort to implement a personnel safety program. Alyeska's Employee Safety Program is effective in minimizing risk to personnel. No negative trends were noted and accident statistics are below the national average. These conclusions are consistent with accident statistics and the results of JPO's field surveillance and assessments. JPO determined that Alyeska is in compliance with the requirements of their Corporate Safety Manual (SA-38), with some exceptions noted in Chapter 2. JPO considered these exceptions to be minor in nature and Alyeska has satisfactorily addressed each finding.

- **JPO will continue to closely monitor the TAPS Safety Program.**

JPO will continue to closely monitor Alyeska's compliance with the safety stipulations of the grant and lease. Ongoing surveillance of selected sections of SA-38 assures JPO and its stakeholders that Alyeska will maintain and improve their Employee Safety Program.

PROJECT PERFORMANCE Executive Summary

September 1998

The Joint Pipeline Office (JPO) selected eight 1997 TAPS projects for in-depth review and evaluation. JPO conducted surveillances and assessments and reviewed project documents to reach the following conclusions about Alyeska's project performance:

- **Alyeska conducted projects in a manner that minimized risk to the environment and worker safety. As a result of the work done on these projects, the risk to pipeline system integrity has been reduced.**
- **The pipeline excavation projects were implemented to enhance and protect pipeline system integrity and pipeline safety.**
- **Improved planning for some TAPS projects would have lessened the risk to pipeline system integrity during projects such as the Tank 140 and Wilber Creek Corrosion Investigations.**
- **Projects selected for evaluation complied with Stipulation 1.7, *Notices to Proceed* of the Federal Grant and State Lease.**
- **Alyeska projects had no agency permit violations during 1997.**
- **The Alaska State Department of Labor issued 124 National Electrical Code (NEC) violations to Alyeska's contractor involving some electrical components of the Marine Tanker Loading Vapor Control project at the Valdez Marine Terminal. The notices of violation required Alyeska to fix components not installed according to the Alaska State Department of Labor's (ADOL) interpretation of NEC requirements. JPO did not believe these violations presented a threat to the safe operation of the Marine Tanker Loading Vapor Control system. The violations were considered to be instances of noncompliance with the Federal Grant and State Lease. Alyeska subsequently corrected the violations, and JPO verified they had been corrected.**
- **Some projects lacked sufficient project planning, which led to a fragmented construction process and compromised timely completion of the project. For example, the Wilber Creek and Tank 140 projects would have benefitted from more thoughtful planning. The other excavation projects JPO reviewed were completed without incident, indicating good project planning.**

- **Alyeska and JPO surveillances both documented project and quality procedures that were not consistently followed for some Alyeska projects, particularly the Vapor Recovery and Vapor Control and Tank 140 projects. Alyeska should evaluate the root cause to determine if more training, clearer procedures, additional inspections, or increased accountability could improve future project performance.**
- **Alyeska's response to employee concerns was not timely for project related concerns in 1997, but response time significantly improved in the second quarter of 1998.**
- **Significant audit action items identified by audits conducted by Quality Technology Company, Inc., and Arthur D. Little were found to be recurring in some projects:**
 - 1) National Electrical Code violations for some electrical components of the Marine Tanker Loading Vapor Control project at the Valdez Marine Terminal;
 - 2) use of untraceable project materials; 3) supplies and materials not receiving quality inspections; and 4) improper inspector certification, an item that has subsequently been resolved and closed.

Conclusion

The pipeline system, workers and environment remained safe, but project planning and execution processes showed need for improvement. Some 1997 projects could have benefitted from better project planning, which would have improved construction quality, efficiency and productivity.

Other projects, such as Pump Stations 2 and 6 Ramp Down, Thompson Pass Mainline Pipe Corrosion Investigation, Milepost 799 Mainline Pipe Corrosion Investigation and other repair projects were implemented with thorough planning. These projects were completed on time with minimum controversy and expense.

JPO is convinced that most of the issues cited in this report would have been prevented with a stronger quality assurance program, and that better planning for future projects will strengthen quality assurance. However, Alyeska's implementation of their Quality Assurance Surveillance Program did provide continuous improvement for some projects.

The project planning and compliance issues cited in this report are not severe enough to be individually significant. However, if future CMP reports continue to document similar deficiencies, then substantive concerns of Federal Grant and State Lease compliance would emerge. JPO will continue to document Alyeska's management and execution of projects for future CMP reports.

OPERATIONS Executive Summary

February 1999

The Joint Pipeline Office (JPO) conducted field surveillances and assessments in 1997 and 1998, to evaluate selected aspects of Alyeska Pipeline Service Company's operation of the Trans-Alaska Pipeline System (TAPS). This report explains the issues which were addressed, describes their current status, and identifies instances of noncompliance with the Federal Agreement and Grant and State Lease of Right-of-Way. This report's conclusions will not surprise Alyeska. To their credit, Alyeska's own audits and surveillances have identified these concerns and corrective action is underway. In 1999, JPO will continue to oversee Alyeska's TAPS Operation Program, including compliance with the stipulations of the Grant and Lease, to determine Alyeska's effectiveness in resolving these issues.

Principal Conclusions About Pipeline Operations

- **Five of the sixteen stipulations JPO evaluated were in noncompliance with the Grant and Lease. The noncompliances relate to change management and below ground systems deficiencies. The issues vary in significance, however none of them represent an immediate threat to pipeline integrity, public safety, or the environment. Alyeska has been informed all noncompliances must be corrected, and is working to bring them into compliance. JPO will evaluate progress and verify all completed corrections.**
- **Alyeska does not have an effective change management process and has failed to maintain complete and up-to-date records on pipeline system modifications as required by Stipulation 1.18.3. Change is inherent in the operation of TAPS due to technology advances, equipment deterioration, and modifications to improve cost efficiency. Pipeline system changes often have ramifications beyond the physical replacement of equipment that Alyeska's change management processes have not anticipated.**
- **Alyeska's management of the movement of oil needs greater attention to detail, better trending and evaluation of incidents, and more rigorous procedural compliance. JPO will verify implementation of proposed corrective actions.**
- **New leak detection technology has the potential to improve Alyeska's ability to promptly detect and respond to small, slow oil leaks within the pipeline system. Alyeska is reviewing the latest technology for leak detection, which JPO strongly encourages. Alyeska's new transient volume balance system is an improvement, but needs a comprehensive performance evaluation now that start up problems are resolved. JPO incorporated this request as a condition of approval of Alyeska's oil spill contingency plan. Improving leak detection will remain a top priority for oversight.**

Additional Observations and Conclusions

- **Alyeska needs to better trend and evaluate unscheduled pipeline shutdowns to identify any causes not fixed by the planned fiber optic system improvements.**
- **Alyeska did not consistently follow their quality control procedures for calibrating and maintaining pressure control devices and documenting the results. Corrective action plans have been implemented to fix this problem, including a plan to increase surveillance of tracking and controlling pressure relief system devices to prevent these problems from recurring.**
- **A TAPS cold re-start study must first be completed before developing a new plan that includes procedures for re-starting the pipeline under extreme cold conditions after an extended shutdown. Study results will reveal information about system performance in the event of an extended shutdown.**
- **JPO continues to monitor Alyeska's ongoing investigation of an overpressure event that occurred in August 1998. A preliminary Alyeska engineering review concluded that pipeline damage was unlikely. JPO recently obtained the pipeline pig data and is currently evaluating it to verify Alyeska's conclusion. An oversight priority is to ensure Alyeska implements preventive measures to minimize future occurrences.**
- **Employees controlling oil flow have received considerable training. However, Alyeska should complete its qualification and development program initiative and comply with its requirements for self-audit and team qualification plans. Further, Alyeska should revisit controller's training and research information needs to cope with changes in system configuration. JPO encourages Alyeska to make full use of its new pipeline control simulator and to critically evaluate its effectiveness.**
- **Alyeska closed many operations-related audit action items in 1996 and 1997. Presently, five audit items remain open that are planned for completion later this year. However, several items that should significantly improve operations have not yet been closed. Operational deficiencies such as ineffective change management continue to exist, which will, if uncorrected, cause the repeat of many 1993 audit deficiencies. The audit items including change management will not be closed until an effective change management system is in place.**
- **JPO evaluated two issues involving buried pipe and concluded that: 1) the pipe curvature at Mainline Refrigeration Site No. 2, near the Gulkana River, is not a pipeline integrity concern under current operational conditions; and 2) no intervention is needed at Salcha River to address pipeline curvature.**
- **JPO finds Alyeska's Y2K effort to be well planned and organized. Alyeska's late start may increase the cost of the Y2K program, however, JPO does not have concerns about its effectiveness.**

- Alyeska is replacing their current backbone communication system with a new fiber optics system and new valve control units, with the intent to: 1) minimize incidents of communication lapses to remote gate valves; 2) decrease unplanned shutdowns; and 3) enhance pipeline system safety. JPO will verify the reliability and safety of the system, once it becomes operational.
- Alyeska processed and closed two substantiated employee concerns related to operations in 1997-1998. JPO reorganized its employee concerns oversight to better trend and evaluate the concerns of TAPS workers.

MAINTENANCE PROGRAM Executive Summary

April 1999

The Comprehensive Monitoring Program (CMP) report, *An Evaluation of the Selected Portions of the TAPS Maintenance Program January 1997-April 1999*, is JPO's seventh CMP report, but the first to evaluate maintenance performance of the Trans-Alaska Pipeline System (TAPS). The status of six maintenance topics is addressed: preventive and workpad maintenance, electrical systems, slope stability, mineral material sites, and mainline valves.

The performance of most TAPS maintenance areas JPO evaluated has either improved or remained the same since the early 1990's. Recent planning, preparation, and execution of mainline valve repair projects achieved a high standard of performance. However, permit and project coordination is an exception, where recent performance has not been as good as Alyeska's previous record.

Compliance. JPO's study of the six maintenance areas included ten stipulations of the Grant and Lease. The aspects of noncompliance contained in this report vary in significance and should be put in perspective. Some aspects of noncompliance have previously existed on TAPS and have been corrected by Alyeska. Only recently did JPO begin reporting them using the CMP process.

Pipeline Integrity. The most significant aspect of noncompliance relates to pipeline integrity. JPO is concerned that two slopes have not been demonstrated to be stable enough to support the above ground pipe in the remote possibility of a large earthquake. JPO and Alyeska are actively studying these slopes. This report presents the interim status of evolving technical evaluations of the slopes and does not suggest a lack of responsiveness on Alyeska's part. If these slopes cannot be shown as safe, civil improvements must be made to fix them. Alyeska and JPO continue to monitor other slopes greater than 10% with no issues noted at this time.

Change Management. Alyeska needs to improve their management of TAPS system changes. Referred to as "change management," this issue was discussed in JPO's February 1999, CMP report about pipeline system operations. However, Alyeska has made progress with new controls that require completion of all updates and revisions before a modified system is "turned

over" to the system operators. They are improving their ability to detect system interactions, documents and parameters.

Principal Conclusions About TAPS Maintenance

- **Five of the stipulations evaluated contain some aspects of noncompliance. The areas of noncompliance include slope stability, failure to update records for system changes and civil maintenance, inconsistency between existing conditions and design requirements, and vegetation damage at material sites. Alyeska has efforts underway to address each issue. JPO will verify completed corrections.**
- **Two slopes at Squirrel Creek are not in compliance with design basis requirements and Stipulation 3.5, *Slope Stability* of the Grant and Lease. Instrumentation data shows the Squirrel Creek slopes are thawed, resulting in a degradation of permafrost and a noncompliance with Stipulation 3.9, *Construction and Operation*. The degree of integrity of the Squirrel Creek slopes under design contingency earthquake conditions is in question and under review by JPO and Alyeska. If these slopes cannot be demonstrated as being safe, civil improvements must be completed. Alyeska has scheduled a risk assessment for this year to evaluate the Squirrel Creek slopes. They recently completed the Pump Station 11 slope risk assessment, which JPO is currently reviewing. Alyeska concluded in their Pump Station 11 risk assessment the probability of a crude oil leak or spill is very remote. Appropriate mitigation actions will follow the review of the risk assessments.**
- **The Alaska Department of Labor electrical inspector found six National Electrical Code (NEC) violations on TAPS that were within the scope of this review. Alyeska corrected the violations and JPO verified the corrections. Alyeska now requires third party inspection of electrical installations and modifications. If consistently followed, this requirement should prevent future noncompliance with the National Electrical Code.**
- **Alyeska is meeting their commitments of the mainline valve testing and repair program. Recent planning, preparation, and execution of mainline valve repair projects achieved a high standard of performance. Maintenance goals include 1) testing of 44 mainline valves for internal leak-through in 1998, and testing of the remaining mainline valves by the year 2000, 2) repairing Check Valve 122, and 3) replacing Remote Gate Valve 80. The last two items were completed in 1998.**
- **Alyeska has not coordinated well with JPO's regulatory agencies during the planning, scheduling, and design of a number of maintenance projects along the TAPS right-of-way. This, coupled with Alyeska's lack of internal coordination, resulted in delays in the permitting and execution of some projects. To correct this problem, Alyeska is clarifying roles and responsibilities and providing additional training to their asset managers.**
- **Alyeska's maintenance records have only partially documented some workpad and above ground maintenance repairs. This hinders the trending of damage caused by**

flood, erosion and thawing. JPO considers this to be an instance of noncompliance with Grant and Lease Stipulation 1.18, *Surveillance and Maintenance*. Although Alyeska disagrees this deficiency is a noncompliance with this stipulation, they are working to improve tracking of civil maintenance repairs.

- New projects were commissioned and turned over to pipeline operators without the necessary preventive maintenance procedures. Other electrical system modifications lacked updated drawings. Alyeska changed procedures to ensure timely completion of preventive maintenance procedures and project records.

Additional Observations and Conclusions

- Alyeska has not met scheduled goals for some parts of the mainline valve program, including below ground valve investigations and the mainline valve maintenance review. Instead, resources were committed to the repair of Check Valve 122 and replacement of Remote Gate Valve 80. Alyeska plans to accelerate their 1999 schedule to catch up on below ground valve investigations.
- Preventive maintenance work required by regulation was completed within required time frames, which was an improvement over 1996 and 1997 performance. However, JPO discovered that nonregulated preventive maintenance work orders were behind schedule.
- The material sites Alyeska uses are clean and well maintained. Erosion was not evident at any sites. However, not all the material sites met mineral sale requirements. Two sites had excessive vegetation damage and six sites had slopes that exceeded requirements for steepness. Corrections will be verified in 1999.
- JPO incorporated issues from concerned TAPS workers into its monitoring. Two of the TAPS workers concerns were validated after JPO's investigation. One concern involved the maintenance of fire alarm and suppression systems by employees without the appropriate state fire marshal permits. This concern was validated at one pump station. The other concern was that not all electrical work received third party inspections when required. This concern was validated when the six NEC violations were written by the Alaska State Electrical Inspector.
- Alyeska closed the remaining 1993 maintenance related audit action items. The six NEC violations written during this review were recurrences of previously closed audit action items. Additional monitoring by Alyeska and JPO is needed to ensure the corrective action to have a third party inspection of electrical installations and modifications is followed.

Commitment 2.

Complete the staff work necessary for the renewal of the Alaska Native Utilization Agreement.

Section 29 of the Federal Grant of Right-of-Way requires Alyeska to target Alaska Natives for recruitment, training, testing, placement, and employment on TAPS. The Agreement is up for renewal every three years.

JPO and Alyeska met frequently in the past year to discuss renewal of the Alaska Native Agreement. JPO also solicited Native community comments on the renewal of the Agreement from 50 Native organizations which were considered in meetings with Alyeska.

At the Alaska Federation of Natives' annual convention October 15, 1998, the renewed Agreement was signed by Sylvia Baca, Deputy Assistant Secretary of the Interior for Land and Minerals Management, and Bob Malone, President of Alyeska Pipeline Service Company.

The renewed Agreement features several improvements including:

- establishment of a "Gateway" process whereby Alyeska will assist qualified Alaska Native employees and trainees in finding oil and gas industry work when an Alyeska position cannot be found;
- expansion of coverage to more TAPS contractors and subcontractors; and
- linkage of scholarship expenditures directly to TAPS or other oil and gas industry jobs.

One provision of the Agreement requires the TAPS work force to be comprised of 20% native employment among Alyeska and its' contractors by 2004. The percentage increases each year until that time. The 1998 employment goal was 10%. Combined Alyeska/contractor Native employment achieved nearly 13%.

1998 Year-End Work Force Statistics -

Total TAPS work force	2,390
TAPS Alaska Native work force	307
Percent Alaska Native workforce	12.7%

Commitment 3.

Evaluate and revise the Oil Spill Response Plan to provide for timely oil spill response capability for TAPS.

Oil spill contingency plans are required by the Grant, the Lease, and Federal and State Statutes. Among JPO agencies, these requirements are administered by the Alaska Department of Environmental Conservation, Bureau of Land Management, and Environmental Protection Agency with the Department of Environmental Conservation having the most prescriptive regulations. The JPO Oil Spill Prevention, Preparedness, and Response Coordination Team, comprised of representatives from these agencies, worked together in 1997 and 1998 to evaluate the revised Oil Spill Response Plan submitted by Alyeska for renewal.

The Contingency Plan is reviewed by regulating agencies to ensure that all legal requirements are met. The legal requirements are important because they provide the commitment of people and resources to assure industry uses prudent practices to keep the oil contained and to assure that a rapid and effective response will happen if needed.

Alyeska's Contingency Plan was substantially re-written in 1991 in a combined effort between Alyeska and the participating JPO agencies. In 1994 the plan was revised and approved as a result of the State's then newly promulgated oil pollution control statutes and regulations. This review was the triennial review of the 1994 approved plan. The plan has again been revised with significant changes to format, including the change from 12 sectional volumes to 5 regional volumes, and a closer adherence to the Department of Environmental Conservation recommended format.

Alyeska's Oil Discharge Prevention and Contingency Plan embraces actions to prevent an oil spill and provides the necessary information should a spill occur for effective clean-up. In most cases, once a spill happens the ability to effectively clean-up and avoid impacts to the environment ranges from poor to moderately good depending upon many variables. Alaska law may well be the most demanding in the world with respect to the level of clean-up performance expected of the oil industry.

Several significant changes in the way Alyeska operates and manages the pipeline in the past few years have had an impact on the Contingency Plan. Alyeska has undergone dramatic changes in response to the economics and lessons learned from Federal and third party audits. With oil flow reduced to around 1.2 million barrels, operation of four of the eleven pump stations have been shut down in the last two years. The company changed from an Anchorage-based organization to one centered in Valdez and Fairbanks.

JPO's review of the Contingency Plan began in July 1997. The plan was granted several extensions to accommodate requests for information and allow for adequate public review. The JPO conducted public open houses and public hearings in Anchorage, Fairbanks, Valdez,