

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672
2647 SCOMM 118 HOUSE SPECIAL COMMITTEE OIL & GAS, 1999-2000

STATE OF ALASKA PERMIT REQUIREMENTS

AGENCY	PERMIT	JURISDICTION	AUTHORITY	
DEPARTMENT OF LABOR (Continued)			AS 18.62.020	Certificate of Fitness
			8 AAC 90.010 - 900	
			AS 18.010	Occupational Health & Safety
			8 AAC 61.010 - 960	
			AS 18.52.010	Explosive handlers Building
			6 AAC 62.010 - 070	Safety Regulations
			9 AAC 75.010 - 030	
			AS 8.18.011	Contractor Licensing
			12 AAC 21.010 - 300	Construction Contractors
			AS 8.40.010	Electrical Administration
			12 AAC 02.010 - 900	
			AS D6.40.210	Mechanical Contractor
			12 AAC 39.005 - 990	
DEPARTMENT OF NATURAL RESOURCES				
Division of Forestry	Burning Permit	Burning of any material in designated areas of the State.	AS 41.14.010-170	Protection of Forested Lands
			AS 41.15.700	General
			11 AAC 92	Forest Protection
Pipeline Coordinators Office	Miscellaneous Land Use Permit	Surface activities and the usage of equipment on special State-owned land.	AS 38.05.035	Powers and Duties of the Director
			AS 38.05.310	Permits
			11 AAC 96	Miscellaneous Land Use Regulations
	Right-of-Way or Easement Permit.	Construction of roads, trails, ditches, pipelines, drill sites, log storage sites, telephone line or similar use of improvement on State land.	AS 38.05.035	Powers and Duties of the Director.
			AS 38.05.330	Permits
			11 AAC 58.200	Right-of-Way or Easement Permit
	Temporary Water Use Permits		AS 46.15.030	

STATE OF ALASKA PERMIT REQUIREMENTS

AGENCY	PERMIT	JURISDICTION	AUTHORITY
DEPARTMENT OF NATURAL RESOURCES (Continued)			
Pipeline Coordinators Office (Continued)			
Pipeline Coordinator	Pipeline Right-of-Way Lease		AS 35.35.050
	Notices to Proceed		
	Field Memos.		
	Engineering Approvals.		
Division of Water	Water Rights Permit.	Appropriation of waters of the State.	AS 46.15.030-185 11 AAC 72 Appropriation and Use of Water. Water Use.
Division of Parks	Access Route Permit.	Easements across State park lands or waters to privately owned property.	AS 41.20.020 AS 41.20.040 AAC 18.020 Duties of the Department of Natural Resources. Divisions within the Department of Natural Resources. Access Routes
	Disturbance of Natural Material Permit.	Removal of certain materials for Collection, preservation for for studies and interpretation purposes from State parks.	AS 41.20.020 AS 41.20.040 Duties of the Department of Natural Resources Divisions within The Department of Natural Resources.

STATE OF ALASKA PERMIT REQUIREMENTS

AGENCY	PERMIT	JURISDICTION	AUTHORITY	
DEPARTMENT OF NATURAL RESOURCES (Continued)				
Division of Parks (Continued)				
	Field Archaeology Permit	Archaeological surveys or excavations on State owned or controlled land.	AS 41.35 11 AAC 16	Alaska Historic Preservation Act., Historic, Prehistoric and Archaeological Resources.
	Special Land Use Permit - Construction of signs and Structures.	Structures or signs constructed or maintained on State owned land or waters.	AS 41.20.020 AS 41.20.040 11 AAC 12.140	Duties of the Department of Natural Resources. Division within The Department of Natural Resources. Construction of Structures
	State Park Noncompatible Use Permit.	Projects within the boundaries of a State park which would require the use of the land or waters, including easements.	AS 41.20.020 AS 41.20.040 11 AAC 18.010	Duties of the Department of Natural Resources Divisions within The Department of Natural Resources State Park Noncompatible Uses .
DEPARTMENT OF PUBLIC SAFETY				
Division of Fire Prevention	Fire Extinguisher Servicing Permit	Servicing, repairing, filling, installing.	AS 18.70.080 13 AAC 50.030(e)	Regulation-, Fire Prevention. Fire Detection and Control
Division of Fire Prevention	Life and Fire Safety Plan Check for the Construction and Occupancy of Buildings.	Conformance of buildings to State fire Safety Regulations.	AS 18.70.080 13 AAC 50.020(c)	Regulations, Fire Prevention Building Codes

STATE OF ALASKA PERMIT REQUIREMENTS

AGENCY	PERMIT	JURISDICTION	AUTHORITY	
DEPARTMENT OF PUBLIC SAFETY (Continued)			AS 28.05.020 AS 19.10.060	Authority of Commis- Regulation of Weight and Load of Vehicles and Use of Highways During Certain Seasons sioner of Highways to adopt Regulations.
Bureau of Vehicle Enforcement	Application and Permit for Oversize and Overweight Vehicles.	Movement of overweight or oversized loads or vehicles over the Alaska Highway System.	AS 28.05.025	Authority of Department of Commerce to Adopt Regulations.
DEPARTMENT OF REVENUE				
Taxpayer Service Center	Alaska Business License	All business activity.	AS 43.70 15 AAC 05	Alaska Business License Act Alaska Business License Tax.
DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES				
Airport Leasing	Airport Building Permit, Non- International Airports	Placing of fill, excavation, or building or altering any struc- ture on the land of a State operated trunk and secondary airport.	AS 02.15.020 14 AAC 10.360(8) (11)	Powers of the Department General Lease / Permit Provisions
	Airport Land Lease	Leasing any airport land on a State operated airport.	14 AAC 10.300 - 390	Leasing State Airport Lands and Facilities
Regional Utilities	Utility Permit for Encroach- ment Within Highway Rights-of- Way.	Construction, placing or main- taining utilities under, on, in, or over the highway rights- of-way.	AS 19.25.010 17 AAC 15	Use of Rights-of-Way for Utilities. Engineering-Utility Permits

STATE OF ALASKA PERMIT REQUIREMENTS

AGENCY	PERMIT	JURISDICTION	AUTHORITY	
DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES (Continued)				
Right-of-Way and Land Acquisition	Encroachment Permit	Construction, placement, change or maintenance of an encroach- ment across or along a public highway or right-of-way.	AS 19.25.200 17 AAC 10.010	Encroachment Permits. Encroachments.
Regional Maintenance and Operations	Driveway Permit.	Construction of driveways or road approaches within State highway lands or rights-of-way.	17 AAC 10.200	Driveways and Road Approaches.
Regional Maintenance and Operations.	North Road Vehicle Permit	All vehicles traveling on the North Road" (North Slope Haul Road) from the Yukon River to Deadhorse.	AS 19.05.020 17 AAC 30.010- 070	Duties of the Department North Road Operations
	Permit for Pipeline Crossings.			



**YUKON
PACIFIC
CORPORATION**
TRANS-ALASKA GAS SYSTEM

February 25, 2000

Messrs. Jerry Brossia and William Britt
Joint Federal/State Pipeline Office
411 West 4th Avenue
Anchorage, AK 99501

RE: YPC Information Regarding Legislative Request

Dear Bill and Jerry:

This letter is written in response to yours of February 17 soliciting YPC's input to JPO in anticipation of your providing Representative Whitaker with information relating to various potential gas pipeline projects.

YPC has been in existence long enough for you to have a good grasp of the TAGS project, and we hope our presentation to you and your staffs here on December 15, and again on February 9, provided more useful information on our current status. Thus, we see no reason to inundate you with material.

We do believe, however, as we stated on February 9, that it is important that JPO, Representative Whitaker, and others interested in an LNG export project understand that the permitting aspects of such a project are large, lengthy, and particularly complicated by the fact that there is no one source for information regarding the entire permitting process. To this end I am enclosing a brief summary of the TAGS "permits," and five diagrams with associated brief text that puts in perspective the roles of the various regulatory agencies involved. This is an extension of the single diagram we distributed to you on February 9.

Our intent is to impress upon readers that they cannot expect to understand the totality of the permitting process unless they speak with each individual agency, because while one source may be knowledgeable about its own area of expertise, it is highly unlikely to be conversant with the entire process.

Thanks for your consideration of this material.

**House Special Committee on Oil and Gas
March 23, 2000
Hearing on Trans-Alaska Gas Pipeline Permits
Yukon Pacific Corporation**

**Yukon Pacific Corporation
1049 W. 5th Ave.
Anchorage, AK 99501
(907) 265-3100
(907) 265-3180 fax**

Testifying:

**Mr. Jeff Lowenfels
President, YPC**

**Mr. Wayne Lewis
Vice President, YPC**



February 24, 2000

William G. Britt, Jr.
State Pipeline Coordinator
Alaska Department of Natural Resources
411 West 4th Avenue, Suite #2
Anchorage, Alaska 99501

RE: Potential Natural Gas Pipeline Projects; Letter No: 00-028(a)mc

Dear Mr. Britt;

Please give full consideration to a Cook Inlet route.

I make this request with an understanding of the impact route selection will have on Alaskans and the entire state's economic future. Alaska has a great deal at stake. In recognition of this I have formed the Cook Inlet Pipeline Terminus Group to educate Alaskans that bringing Alaskan natural gas to major population and industrial centers will benefit the state. Our group is just getting started, but the response has been very good as most Alaskans reside and do business on the route to Cook Inlet.

At this time we are not forming a Port Authority like the Valdez group. We are working in conjunction with the sponsor group. They should be deciding soon whether they are doing a Cook Inlet route or a Valdez route.

I appreciate your giving me an opportunity to give input regarding this important issue. I would like to receive a copy of your response to Representative Jim Whitaker's request.

Sincerely,

Dale F. Bagley

Dale Bagley, Mayor
Kenai Peninsula Borough
Chair of Cook Inlet Pipeline Terminus Group

Cook Inlet Pipeline Terminus Group

Box 3029
Kenai, Alaska 99611
283-6451 283-3913 (fax)
www.alaskagasline.org

CORRECTION

**THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION**



Rev. 6/98

Central Microfilm Services
Department of Education & Early Development
State of Alaska



February 25, 2000

Messrs. Jerry Brossia and William Britt
Joint Federal/State Pipeline Office
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Anchorage, AK 99501

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Thanks for your consideration of this material.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Mike", written in a cursive style.

Michael C. T. Smith
Manager, Permitting/Environmental Affairs

**House Special Committee on Oil and Gas
March 23, 2000
Hearing on Trans-Alaska Gas Pipeline Permits
Yukon Pacific Corporation**

**Yukon Pacific Corporation
1049 W. 5th Ave.
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February 24, 2000

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State Pipeline Coordinator
Alaska Department of Natural Resources
411 West 4th Avenue, Suite #2
Anchorage, Alaska 99501

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Sincerely,

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Dale Bagley, Mayor
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Chair of Cook Inlet Pipeline Terminus Group

Cook Inlet Pipeline Terminus Group

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Alaska State Legislature

Representative Jim Whitaker

Session
Capitol Building, Room 13
Juneau, Alaska 99801
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Interim
119 N. Cushman St. Suite 101
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Phone: (907) 452-1088
Fax: (907) 452-1146

Bill Britt
Joint Pipeline Office
411 W. 4th Avenue, Suite 2-C
Anchorage, AK 99501

February 5, 2000

Dear Mr. Britt,

This letter is written as a follow-up to our recent telephone conversation. Pursuant to that conversation, this is a request to the Joint Pipeline Office to provide evaluations of state and federal permitting requirements for several Alaska North Slope natural gas proposals. The proposals are:

1. Prudhoe Bay to Valdez, as proposed by Yukon Pacific Corporation and The Alaska Natural Gas Pipeline Port Authority (also please include, as a separate item, permitting requirements associated with a spur line from a logical point to a Cook-Inlet/Nikiski terminus).
2. Prudhoe Bay to Cook-Inlet
3. Prudhoe Bay to the lower 48, through Interior Alaska and Canada.
4. Prudhoe Bay to the lower 48, off-shore through Canada.

Please feel free to add other viable proposals that have not been listed.

Your evaluation is not expected to be exhaustive, but rather a basic assertion of permit requirements; brevity and point of fact are requested.

Also, interested parties are being notified of this request. This is being done in order to provide them the opportunity to have input to the J.P.O. regarding their specific interests and concerns. I therefore make an additional request that you provide them a timely opportunity, at their instigation, to have input.

Please feel free to call me should you have questions or comments.

Sincerely,

A handwritten signature of Jim Whitaker in black ink.

Jim Whitaker
Alaska House of Representatives

Cc: Jerry Brossia, Joint Pipeline Office
Mayor Hove, Alaska Natural Gas Pipeline Port Authority
Mayor Bagley, Cook Inlet Pipeline Terminus Group
Jeff Lowenfels, Yukon Pacific Corporation
Jim Eason, Sponsor Group

Current YPC/TAGS Project Cost Estimates*

	PHASE I	EXPANSION I	EXPANSION II
Annual LNG Volumes Delivered to Asia:	9 Million Metric Tons	13.5 Million Metric Tons	18 Million Metric Tons
Project Size:	(2 LNG Trains)	(3 LNG Trains)	(4 LNG Trains)
Pipeline/Compressors & LNG Plant/Marine Terminal ¹	\$5.357 Billion	+ \$958 Million	+ \$1.041 Billion
North Slope Gas Conditioning Plant ²	+ \$1 Billion	+ \$500 Million	+ \$500 Million
Ships ²	(9 ships) <u>+ \$1.8 Billion</u>	(4 additional ships) <u>+ \$800 Million</u>	(4 additional ships) <u>+ \$800 Million</u>
TOTAL	\$8.16 Billion	\$10.42 Billion	\$12.76 Billion

¹ Estimates prepared for YPC by Willbros, Michael Baker Jr., Kellogg (January 2000)

² YPC Estimates

* Includes only facilities required for export quantities shown.

February 16, 2000

SCOMM

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ALASKA STATE LEGISLATURE



REPRESENTATIVE ALLEN KEMPLER

DATE: February 9, 2000

TO: Representative Jim Whitaker
Chair, Oil and Gas Committee

FROM: Representative Allen Kempler 

RE: TAPS and Alleged Income Tax Surcharge Fraud

In the Forum section of the February 8th Anchorage Daily News, there was an article written by Richard Fineberg entitled, "New filings reveal oil pipeline owners' tax scam." A copy is attached. Mr. Fineberg addresses a recent finding by the department of law that the pipeline owners have been including an income tax surcharge on all DR&R payments, as allowed under TAPS ('85), even though they received an IRS ruling in 1988 that obviated the income tax charge on tariff collections for DR&R. This has serious implications for the state. I believe that this subject warrants a hearing before the Oil and Gas committee with testimony from Mr. Fineberg and the Dept. of Law. If you have any questions, I would be more than happy to discuss this issue with you.

SESSION
STATE CAPITOL
JUNEAU, ALASKA 99801-1182
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New filings reveal oil pipeline owners' tax scam

By RICHARD FINEBERG

The owners of the Trans-Alaska Pipeline System (TAPS) are cheating the Alaska and other oil shippers by charging pipeline shippers for federal income tax payments that the companies don't actually pay, according to documents filed by the Alaska Department of Law in January at the Regulatory Commission of Alaska.

The tax machination in question relates to the portion of pipeline tariffs (shipping charges) to pay for eventual dismantling, removal and right-of-way restoration (DR&R) of the oil pipeline. The generous schedule for advance collection of future pipeline dismantling charges were first identified as a source of a huge windfall profit to the pipeline owners more than a decade ago. However, the Department of Law's recent disclosures reveal a long-running problem that apparently escaped attention of state officials until last month.

The 1985 TAPS Settlement Agreement, which sets the formula for pipeline tariff collections, allows the pipeline owners to include an income tax surcharge on all DR&R payments. But according to a brief the Department of Law filed Jan. 10, instead of actually making those tax payments, the pipeline owners obtained a 1988 ruling from the Internal Revenue Service allowing the pipeline owners to take early, annual tax deductions on DR&R income — long before that money is actually spent on dismantling.

The IRS ruling obviated the in-



come tax charge on tariff collections for DR&R. Nevertheless, that charge still remains in the pipeline tariff DR&R payments.

Pipeline system DR&R charges are minimal today. However, since pipeline start-up, tariff collections to pay the federal tax on DR&R income have averaged approximately \$50 million a year in 1999 dollars. Because pipeline costs are subtracted before state royalty and severance payments are calculated, a \$50 million addition to the pipeline tariff reduces state revenue by approximately one-quarter of that amount, or \$12.5 million.

Apart from its effects on state revenue, this multimillion-dollar scam handicaps North Slope competitors to the pipeline owners because developers of North Slope oil discoveries without an ownership interest in the pipeline must pay an artificially inflated pipeline tariff to get their oil to market.

Tesoro Alaska Petroleum Co. has challenged the TAPS tariffs at the RCA. According to Tesoro's complaints, DR&R charges are just one reason that the oil pipeline tariffs are too high. As a party to the 1985 tariff agreement, the Department of Law has opposed Tesoro's complaint.

But last September the RCA requested all parties to file legal briefs

on various aspects of the DR&R question, including its tax treatment. In preparing its response, the Department of Law apparently discovered that although the 1985 TAPS settlement agreement increased DR&R collections to pay federal income tax, the pipeline owners then "took federal tax deductions for TAPS DR&R in advance of incurring the actual expense."

According to the brief, the state's preliminary estimates suggest that had the 1985 TAPS settlement agreement taken actual tax deductions into account, the tariff charges for DR&R "could have been a fraction of what the schedule currently provides." For this reason, the brief urges, "the advance tax-deductibility of the TAPS DR&R expense is an important issue that warrants further inquiry. The state requests that the Commission investigate this issue."

To document its concern, the Department of Law included a portion of a 1990 petition filed by Exxon Corp. that cites a 1988 IRS ruling giving Exxon a tax deduction on its DR&R collections. Even at this late date, the Department of Law still does not have the 1988 document, which the pipeline owners claim should remain confidential.

The Department of Law's revelations to the RCA are devastating to the industry's credibility; when you collect money for a stated purpose and then divert that money to your own pocket, that's tantamount to fraud. Disclosure of this long-running scam also undermines Gov.



Apart from its effects on state revenue, this multimillion-dollar scam handicaps North Slope competitors to the pipeline owners because developers of North Slope oil discoveries without an ownership interest in the pipeline must pay an artificially inflated pipeline tariff to get their oil to market.

Tony Knowles' claim — in a press conference Feb. 3 — that the state needs to intervene at the Federal Trade Commission on the proposed BP Amoco-Atlantic Richfield Co. deal because "we have total knowledge of all the upstream issues that can't be provided by other states. ... They don't have a clue."

In addition to reducing state revenue and its anti-competitive effects on North Slope development, the recent disclosures raise two points with relevance to the current deliberations over the proposed BP-Arco deal:

- The existence of this long-running scam demonstrates the ease with which the oil industry can manipulate costs of transportation in the isolated West Coast market.

- In view of the numerous public questions about TAPS dismantling charges since 1986, the fact that the state has only recently discovered that the oil companies have been

claiming one thing and doing another in its tax filings — to their benefit and at the expense of the state treasury — suggests that state officials may be poorly equipped to deal with their partners in the North Slope oil patch.

By increasing BP's power and reducing sources of information about the complicated business of oil development, transportation and marketing, the proposed takeover can only make things worse.

□ Richard A. Fineberg, who lives outside Ester, served as a senior adviser to the governor on oil and gas policy from 1987-89 and now consults primarily for government and nonprofit groups. He is the author of "The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope" (executive summary at www.home.gci.net/~oilwatch/squeeze.htm) and "State Ownership of TAPS: Why It Should Be Considered and How It Would Work" (www.home.gci.net/~oilwatch/ak-taps.htm).

R.C.A.
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ATTORNEY GENERAL'S OFFICE
(JAN 11 1999)

STATE OF ALASKA

BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Patricia M. DeMarco
James S. Strandberg

In the Matter of the Petition of TESORO ALASKA)
PETROLEUM COMPANY for an Investigation into)
the Amounts Collected by AMERADA HESS) P-97-7
PIPELINE CORPORATION; ARCO)
TRANSPORTATION ALASKA, INC.; BP)
PIPELINES (ALASKA) INC.; EXXON PIPELINE)
COMPANY; MOBIL ALASKA PIPELINE)
COMPANY; PHILLIPS ALASKA PIPELINE)
CORPORATION; and UNOCAL PIPELINE)
COMPANY for Dismantling, Removal and Restoration)
of the Trans Alaska Pipeline System)

STATE OF ALASKA'S BRIEF ON DR&R LEGAL ISSUES

On September 10, 1999, and September 22, 1999, the Commission ordered the parties to brief several legal issues pertaining to TAPS dismantlement, removal and restoration ("DR&R"). The issues and the State's short answers to each of them are as follows:

(1) Does the Commission have jurisdiction in this case over all of the DR&R funds collected or just the intrastate amounts?

Answer: The Commission has jurisdiction in this case only over DR&R funds collected through the intrastate tariff.

ATTORNEY GENERAL, STATE OF ALASKA
STATE CAPITOL
P.O. BOX K, JUNEAU, ALASKA 99811
PHONE 465-3600

1
2 (2) Does the APUC's approval of the TAPS Settlement Methodology
3 preclude the Commission's consideration of the requirement of establishing an external fund
4 for DR&R?
5

6 **Answer:** The APUC's prior approvals of the TSM do not preclude the
7 Commission's consideration of the requirement of establishing an external fund for DR&R.
8 Nevertheless, the State opposes establishing such a fund.
9

10 (3) What happens under the TAPS Settlement Methodology and as a matter
11 of law if the amount collected for DR&R is less or more than the amount needed?

12 **Answer:** (a) The 1985 TAPS Settlement Agreement ("1985 TSA")
13 provides a fixed schedule of DR&R allowances that can be collected by the TAPS Carriers
14 between 1977 and 2011. Accordingly, the 1985 TSA prohibits the TAPS Carriers from
15 collecting any more than is provided. The 1985 TSA does not address the issue of
16 overcollection--this issue will not mature until after TAPS is dismantled.
17

18 (b) As a matter of law, the TAPS Carriers must refund
19 overcollections of DR&R funds to shippers.

20 (4) Would a Commission order requiring deposit of DR&R funds in a
21 separate account be retroactive ratemaking?
22

23 **Answer:** A Commission order requiring deposit of DR&R funds in a
24 separate account would not be retroactive ratemaking. Nevertheless, the State opposes
25 establishing such a fund.
26

(5) What is the appropriate tax treatment of the DR&R funds?

Answer: The 1985 TSA contemplated that the allowable DR&R funds
would be treated as taxable income by the TAPS Carriers and subject to State and federal

1
2 corporate income taxes. The 1985 TSA also contemplated that the TAPS Carriers could not
3 take deductions for DR&R expenses until such expenses were actually incurred.

4
5 Accordingly, the 1985 TSA schedule of DR&R allowances was "grossed-up" to account for
6 such tax treatment.

7 The TAPS Carriers, however, took federal tax deductions for TAPS DR&R
8 in advance of incurring the actual expense of DR&R. The State is currently evaluating the
9 ramifications of this, and is not able to submit a complete answer to the Commission's
10 question at this time.

11
12 The State submits this brief in response to the Commission's questions.

13 **I. DOES THE COMMISSION HAVE JURISDICTION IN THIS**
14 **CASE OVER ALL OF THE DR&R FUNDS COLLECTED**
15 **OR JUST THE INTRASTATE AMOUNTS?**

16 The jurisdiction of a State agency extends no farther than that prescribed by
17 statute. Far North Sanitation v. Alaska Pub. Util. Comm'n, 825 P.2d 867, 870-871 (Alaska
18 1992); Glacier State Telephone Co. v. Alaska Pub. Util. Comm'n, 724 P.2d 1187, 1190
19 (Alaska 1990). Accordingly, the Commission's authorizing statute, the Alaska Pipeline Act,
20 AS 42.06, governs the extent to which the Commission has jurisdiction over DR&R funds.

21 The Alaska Pipeline Act provides:

22 The Commission

- 23 (1) shall regulate pipelines and pipeline carriers in the state;
- 24 (2) may investigate upon complaint or its own motion, the rates,
25 classifications, rules, regulations, prices, services, practices, and
26 facilities of pipeline carriers, and the performance of obligations
under and compliance with the terms of leases issued by the State;

(3) may make prescribe, or require just, fair, and reasonable rates, classifications, regulations, practices, services, and facilities for pipeline carriers

AS 42.06.140(a). Since the TAPS DR&R obligation arises, in part, from the State TAPS Right-of-Way Lease, and TAPS tariffs incorporate a charge for DR&R, this statute authorizes the Commission to assert jurisdiction over the DR&R issue.

Nevertheless, the Alaska Pipeline Act limits the Commission's section .140(a) jurisdiction in this manner:

AS 42.06.140 applies to oil and gas pipeline carriers regulated under federal law only to the extent not preempted by federal law.

AS 42.06.150. The TAPS Carriers are regulated under federal law by the Interstate Commerce Act, 49 U.S.C.A. app. § 1, et seq. ("ICA").¹ Therefore, the Commission's section .140 jurisdiction over the DR&R issue is limited by whatever preemptive effect the ICA has.

The ICA provides the Federal Energy Regulatory Commission ("FERC")² with exclusive jurisdiction over rates for interstate transportation of oil. The U.S. Supreme Court has long adhered to the notion that "[a]s to interstate regulation, the [Interstate Commerce] Commission is granted the broadest powers to prescribe rates and other transportation details." North Carolina v. United States, 325 U.S. 507, 510, 65 S.Ct. 1260,

¹ Finding the applicable version of the ICA is not exactly straightforward. In 1978, Congress repealed the ICA for all carriers except oil pipelines. See 49 U.S.C. § 60503. The U.S.C.A. published the ICA as it applies to oil pipelines in 49 U.S.C.A. app. until 1996. The applicable version of the ICA may be found in the Westlaw directory "USCA96" under 49 U.S.C.A. app.

² In 1977, Congress transferred ICA jurisdiction from the Interstate Commerce Commission to the FERC. Department of Energy Organization Act, Pub. L. No. 95-91, §§ 306, 401-407, 91 Stat. 565, 581-87 (1977).

1263 (1945). This broad jurisdiction is exclusive, and the states may not interfere—"there can be no divided authority over interstate commerce, and . . . the acts of Congress on that subject are supreme and exclusive." Chicago & N.W. Trans. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 318, 101 S.Ct. 1124, 1131 (1981) (quoting Missouri Pac. R. Co. v. Stroud, 267 U.S. 404, 408, 45 S.Ct. 243, 245 (1925)).

With respect to TAPS, there is no doubt that FERC jurisdiction extends to TAPS interstate tariffs. In 1977, in response to protests filed by the State of Alaska and others, the Interstate Commerce Commission asserted jurisdiction over TAPS interstate tariffs under section 15(1) and 15(7) of the ICA. The Fifth Circuit immediately upheld the ICC's assertion of jurisdiction. Mobil Alaska Pipeline Co. v. United States, 557 F.2d 775, 782-83 (5th Cir. 1977); aff'd sub nom. Trans Alaska Pipeline Rate Cases, 436 U.S. 631, 98 S.Ct. 2053 (1978).

Sections 15(1) and 15(7) of the ICA give the FERC authority to investigate and suspend rates for the interstate transportation of oil. The ICA also authorizes the FERC to prescribe:

[T]he just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation or practice is or will be just, fair, and reasonable

ICA, section 15(1) (emphasis added). The FERC's jurisdiction under section 15(1) therefore extends not only to rates, but also to practices.

Following these first decisions on jurisdiction, Judge Max Kane, the administrative law judge appointed by the FERC to preside over the TAPS tariff case, further delineated the precise boundaries between state and federal regulation of TAPS

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2 tariffs. In response to the contention that the FERC had primary jurisdiction, not only over
3 interstate tariffs, but also over intrastate tariffs. Judge Kane held that the Alaska Pipeline
4 Commission (predecessor to the RCA) had primary jurisdiction over intrastate tariffs.
5
6 Trans-Alaska Pipeline System, 7 F.E.R.C. ¶ 63,049 at 65,230 (1979).

7 Thus, for the past twenty years, there has been no question that the
8 FERC has exclusive jurisdiction over interstate TAPS rates and practices, and the
9 various Alaska utility commissions (APC, APUC, RCA) have primary jurisdiction
10 over intrastate TAPS rates and practices. The method by which collected DR&R
11 funds are preserved for the future (i.e., internally or externally) pertains to a "rate"
12 under ICA section 15(1) and AS 42.06.140(a)(2)-(3). Moreover, even if we assume
13 that the method by which collected DR&R funds are preserved for the future is not a
14 rate, at the very least it is a "practice" under ICA section 15(1) and AS
15 42.06.140(a)(2)-(3). Consequently, the ICA preempts the Commission from
16 asserting jurisdiction over DR&R funds collected through the interstate TAPS tariffs.
17
18 Therefore, the Commission's jurisdiction over DR&R funds is limited to only those
19 funds collected through the intrastate TAPS tariffs.
20

21 Tesoro, however, has suggested in this docket that the Commission
22 does in fact have jurisdiction over all DR&R funds, whether collected through the
23 interstate tariff or the intrastate tariff. RCA Docket P-97-7, Tr. 25 (Sept. 10, 1999).
24
25 Tesoro apparently bases this novel assertion on the fact that the FERC does not have
26 abandonment jurisdiction over oil pipelines. Id. While it is true that the ICA does
not govern the abandonment of oil pipelines (compare repealed ICA section 1a,
governing abandonment of rail lines), this does not limit the FERC's jurisdiction

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2 over TAPS rates and practices as they pertain to DR&R. Tesoro's attempt to
3 disassociate the collection of DR&R funds through TAPS rates and the practice by
4 which such funds are preserved must fail. For purposes of jurisdiction, the DR&R
5 component of TAPS rates, and the practice by which DR&R funds are preserved for
6 the future are inextricably intertwined.
7

8
9 Moreover, the FERC has already asserted jurisdiction over the method by
10 which interstate DR&R funds are preserved for the future, not only in the TAPS context, but
11 also in the Kuparuk and Endicott pipeline cases. See Kuparuk Transportation Co., 45
12 F.E.R.C. ¶ 63,006 at 65,080-082 (1988) (ALJ decision); Kuparuk Transportation Co., 55
13 F.E.R.C. ¶ 61,122 at 61,381-383 (1991) (FERC decision); Endicott Pipeline Co., 55
14 F.E.R.C. ¶ 63,028 at 65,162 (1991) (ALJ decision). The parties to the TAPS tariff case
15 presented several volumes of testimony to the FERC on the various TAPS DR&R issues,
16 including the method by which DR&R funds should be preserved for the future. See Trans-
17 Alaska Pipeline System, F.E.R.C. Docket OR78-1, Phase II, Tr. Vols. 260-269. All the
18 parties in the TAPS tariff case extensively briefed this and other DR&R issues. See Trans-
19 Alaska Pipeline System, F.E.R.C. Docket OR78-1, State of Alaska /ASRC Joint Non-Cost
20 of Construction Post-Hearing Br. at 231-263 (Sept. 3, 1985); Trans-Alaska Pipeline System,
21 F.E.R.C. Docket OR78-1, Joint Initial Brief of Respondents on Phase II Non-Cost of
22 Construction Issues at 279-327 (Sept. 3, 1985). Consequently, the Commission need not be
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2 concerned about the lack of an available forum to take up concerns over interstate TAPS
3 DR&R issues—the FERC is a readily available forum.³
4

5 In sum, the Commission cannot assert jurisdiction over DR&R funds
6 collected through the interstate tariff. Accordingly, the Commission has jurisdiction only
7 over DR&R funds collected through the intrastate tariff.
8

9 **II. DOES THE APUC'S APPROVAL OF THE TAPS SETTLEMENT**
10 **METHODOLOGY PRECLUDE THE COMMISSION'S**
11 **CONSIDERATION OF THE REQUIREMENT OF ESTABLISHING**
12 **AN EXTERNAL FUND FOR DR&R?**

13 The Commission's question is closely related to question #4 concerning
14 retroactive ratemaking, which is discussed in section IV of this brief. Neither the APUC's
15 prior orders nor the rule against retroactive ratemaking prevent the Commission from
16 ordering an external fund for DR&R. Nevertheless, the State does not believe such a fund is
17 necessary and opposes the establishment of such a fund.

18 The Commission has considered the 1985 TAPS Settlement in two orders: (1)
19 Order P-86-2(14), Amerada Hess Pipeline Corp., 8 APUC 168 (May 30, 1987), and (2)
20 Order P-86-2(41), Amerada Hess Pipeline Corp., 13 APUC 448 (Oct. 29, 1993). In the first
21 order, the APUC accepted intrastate TAPS tariffs as permanent for years 1977 through July
22 10, 1986. Amerada Hess Pipeline Corp., 8 APUC at 170. In the second order, the APUC
23 accepted intrastate TAPS tariffs from July 11, 1986 through 1993. Amerada Hess Pipeline
24 Corp., 13 APUC at 455-57.
25
26

³ Notably, Tesoro is no stranger at the FERC. It has actively participated in the FERC's TAPS quality bank dockets and corresponding appeals. See Exxon Co. v. Federal Energy Reg. Comm'n, 182 F.3d 30 (D.C. Cir. 1999).

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3 If the Commission ordered the TAPS Carriers to deposit intrastate DR&R
4 collections in an external account, such an order would not contradict the APUC's 1987 and
5 1993 orders. Review of how dismantlement funding works and the facts of this case
6 demonstrate that such an order would not in any way change the rates accepted by the 1987
7 and 1993 APUC orders.

8
9 In the general public utility context, one of the primary goals of a properly
10 calculated dismantlement charge is to fully fund a dismantlement account such that at the
11 end of a utility asset's useful life, the value of the dismantlement collections plus the
12 accrued interest is equal to the anticipated cost of dismantlement. In situations where a
13 utility will not have any ratepayers after dismantlement, the importance of a fully-funded
14 dismantlement account is increased—otherwise the utility will have insufficient funds to pay
15 for dismantlement, without recourse to its ratepayers.

16
17 The primary motivation for placing dismantlement funds in an external
18 account is to increase the level of assurance that such funds will be available when needed.
19 See, e.g., Nuclear Facility Decommissioning Costs, 52 P.U.R. 4th 618 (Cal. Pub. Util.
20 Comm'n 1983). The method by which collected dismantlement funds are preserved for the
21 future typically does affect rates. An internally-held dismantlement account is likely to earn
22 a higher rate of interest than an external account. Id. Moreover, external accounts are often
23 burdened with management fees. Since utilities usually have to assess ratepayers an
24 increased dismantlement charge when dismantlement funds are deposited in an external
25 account, state utility commissions typically weigh the benefits of additional assurance
26 against the detriments of increased shipper cost. Id.

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3 In general, moving a dismantlement fund from an internal account to an
4 external account mid-stream (i.e., after a utility has begun accumulating dismantlement
5 funds internally) could affect rates: without a corresponding change in the principal amount
6 of the dismantlement charge, the dismantlement fund could end up not fully funded.
7 Assuming a utility were ordered mid-stream to deposit dismantlement funds in an external
8 account, and it was apparent that the external account would not be fully funded because of
9 the decreased rate of return or management fees, the utility's remedy would be to seek
10 permission to increase the future, but not previous, principal amount of dismantlement
11 charges.⁴
12

13 Turning to the facts of this case, a mid-stream shift of DR&R funds from the
14 internally-held "TAPS DR&R sinking fund"⁵ to an external account would not require any
15 change in rates, past or future. Of course, the TAPS Carriers are barred by the 1985 TAPS
16 Settlement Agreement ("1985 TSA") from seeking an increase in future DR&R charges.
17 But there is no question that such would not be necessary.
18

19 According to the State's calculations, the TAPS DR&R sinking fund is now
20 fully funded. In other words, the TAPS Carriers have collected and earned enough to
21

22 ⁴ As noted above, the discussion of retroactive ratemaking is reserved for Section IV of this
23 brief. Nevertheless, such a rate increase, in and of itself, does not constitute retroactive
24 ratemaking. The D.C. Circuit has held that a mid-stream accounting change which shifts
25 costs from past shippers to future shippers, where such future shippers would have borne
26 some of the costs in any event, does not violate the rule against retroactive ratemaking.
Town of Norwood v. Federal Energy Reg. Comm'n, 53 F.3d 377, 381-84 (D.C. Cir. 1995)
(change from cash to accrual accounting method only results in a permissible timing
difference).

⁵ The State uses the term "TAPS DR&R sinking fund" to describe the aggregate value of
each of the TAPS Carriers' DR&R collections plus accrued interest. The precise method by
which each of the TAPS Carriers actually handle DR&R funds is unknown to the State.

1
2 perform the DR&R task if it were required to be performed today.⁶ The sinking fund
3 became fully funded earlier than anticipated under the 1985 TSA because of significant
4 decreases in the anticipated rates of inflation and federal taxes. So long as the return on the
5 TAPS DR&R sinking fund continues to keep pace with the rate of inflation and the
6 anticipated expense⁷ of TAPS DR&R does not increase, it will remain fully funded.
7

8 Therefore, shifting DR&R funds from an internal sinking fund to an external
9 account would require no change in rates, past or future. Accordingly, a Commission order
10 requiring such a shift would not contradict and is not barred by the APUC's 1987 and 1993
11 orders.
12

13 While the State sees no legal impediment to such a Commission order,
14 nevertheless, the State does not support the imposition of an external fund for TAPS DR&R
15 funds. TAPS has been in operation now for nearly 25 years. During that time neither the
16 Alaska State legislature nor any of the permitting authorities with primary jurisdiction over
17 the implementation of TAPS DR&R (Alaska Department of Natural Resources and Bureau
18 of Land Management, U.S. Department of the Interior) have seen fit to impose an external
19 fund for DR&R collections. At this late stage in the TAPS lifespan, the State submits that
20 changing course is a radical step that should only be considered and imposed by the Alaska
21
22
23

24 ⁶ The State's calculations assume historic tax rates, historic rates of inflation and a 12
25 percent pre-tax rate of return since 1985. Under these assumptions the current value of the
26 DR&R sinking fund is approximately \$2.2 billion. The current inflation-adjusted cost of
TAPS DR&R as estimated by the 1985 TSA (\$872.1 million in 1977 dollars) is
approximately \$2.1 billion.

⁷ The Commission should also note that the anticipated expense of TAPS is based on DR&R
studies that were performed between 1977 and 1983. The extent to which these studies
remain accurate predictors of the ultimate TAPS DR&R expense is unknown.

1
2 Legislature or Congress, if at all. Moreover, the State fails to see the need for additional
3 assurance for DR&R funds such as would be provided by an external fund—each of the
4 TAPS Carriers is financially viable and is expected to remain so for the foreseeable future.
5 Finally, requiring such a fund now could result in costly, lengthy and perhaps needless
6 litigation. In sum, there are significant reasons why the Commission should not impose a
7 requirement of a DR&R external fund on the TAPS Carriers at this time.
8

9
10 **III. WHAT HAPPENS UNDER THE TAPS SETTLEMENT**
11 **METHODOLOGY AND AS A MATTER OF LAW IF THE**
12 **AMOUNT COLLECTED FOR DR&R IS LESS OR MORE**
13 **THAN THE AMOUNT NEEDED?**

14 **A. BACKGROUND—A LARGE DR&R OVERCOLLECTION IS**
15 **FORESEEABLE**

16
17 In 1985, none of the parties to the TAPS tariff litigation expected that TAPS
18 would be in operation after 2011. Consequently, the 1985 TSA schedule of DR&R
19 allowances assumed that TAPS DR&R would be completed by 2015. Because of the
20 recently increased life expectancy of North Slope oil production and the corresponding
21 longer need for TAPS, there now appears to be a distinct possibility that TAPS DR&R will
22 take place much later than 2011.

23
24 As explained above, the TAPS DR&R sinking fund is currently fully funded
25 because of lower than expected rates of inflation and federal taxes. As time passes, the
26 sinking fund may increase in value faster than the projected cost of TAPS DR&R. Should
the dismantlement of TAPS be deferred a decade or more later than 2010-2015, the
accumulated interest on the internally-held DR&R funds may produce a large surplus.

The State continues to support the 1985 TSA and the application of its DR&R schedule of allowances for several reasons.⁸ First, while changing rates of inflation and taxes have permitted the TAPS DR&R sinking fund to grow faster than anticipated since 1985, there is no way to predict the future for the next 15 to 30 years. Inflation could increase and taxes could increase, which would reduce any potential surplus. Second, the scope of the anticipated DR&R work could change. For instance, the 1985 TSA assumed that the State and federal permitting authorities (ADNR and BLM) would allow the TAPS Carriers to leave the buried portion of TAPS in place. At some future date, however, these authorities may decide to require removal of the buried portion of TAPS, which could significantly increase the anticipated expense of TAPS DR&R. Note that the TAPS DR&R obligation is unconditional—the TAPS Carriers must perform the required DR&R work, no matter how much or how little they have collected and accumulated in DR&R funds. See Remarks of TAPS Counsel, RCA Docket P-97-7, Tr. 18-19 (Sept. 10, 1999). Third, the 1985 TSA only provides for a total (interstate and intrastate) of approximately \$27 million in DR&R collections over the next decade, a relatively de minimus amount. Finally, and perhaps most importantly, the law does not allow the TAPS Carriers to keep any surplus DR&R money after TAPS dismantlement is completed. The FERC and the RCA must ultimately refund any surplus to shippers so that all parties will be made whole.

In sum, the issue of surplus DR&R funds post-dismantlement is a very significant one for the State, because it is foreseeable that there could be large surplus. As

⁸ With two caveats: (1) the State's right to renegotiate the 1985 TSA matures on January 1, 2007--the State expressly does not waive this right; and (2) satisfactory resolution of the State's questions concerning the DR&R tax deduction issue, discussed in section V of this brief.

discussed next, the 1985 TSA does not address the issue of refunds of DR&R overcollections and case law uniformly requires refunds of DR&R overcollections.

B. THE 1985 TAPS SETTLEMENT AGREEMENT PROVIDES A MAXIMUM AMOUNT OF DR&R FUNDS THAT THE TAPS CARRIERS MAY COLLECT AND DOES NOT ADDRESS THE ISSUE OF OVERCOLLECTIONS⁹

The 1985 TSA provides a fixed schedule of DR&R allowances that the TAPS Carriers may collect from shippers between 1977 and 2011. See State of Alaska's Response to Commission's Joint Stipulation of Facts at 2-3 (Oct. 25, 1999); 1985 TSA at Exhibit E; Trans-Alaska Pipeline System, F.E.R.C. Docket OR78-1, Explanatory Statement of the State of Alaska and the United States Department of Justice in Support of Settlement Offer at Appendix 5, line 117 (June 28, 1985). Accordingly, the 1985 TSA contractually prohibits the TAPS Carriers from collecting any more DR&R funds than is provided by this fixed schedule.

The 1985 TSA does not address the issue of DR&R overcollections. See 1985 TSA at II-2, II-4, II-8, Exhibit E; Trans-Alaska Pipeline System, F.E.R.C. Docket OR78-1, State of Alaska's Explanatory Statement at 30-31. There is no way to know even today, much less in 1985, whether in fact there will be a DR&R overcollection. As noted above, changes in the rates of taxes, inflation and the scope of required DR&R task could reduce or perhaps extinguish any potential overcollection. For these reasons, the overcollection issue had not matured during the 1977-1985 TAPS tariff litigation, and still

⁹ The Commission's question used the terminology "TAPS Settlement Methodology" or "TSM". The TSM is the tariff calculating formula imposed by the 1985 TSA, and so for purposes of clarity, the State will refer to the 1985 TSA instead of the TSM.

has not matured today. Consequently, the 1985 TSA did not settle and is irrelevant to the issue of what happens to overcollections of DR&R funds.

C. DR&R CASE LAW REQUIRES REFUND OF OVERCOLLECTIONS

The FERC and the APUC have uniformly held that dismantlement overcollections must be refunded to shippers. See Tarpon Transmission Co., 57 F.E.R.C. ¶ 61,371 at 62,245 (1991); Kuparuk Transportation Co., 45 F.E.R.C. ¶ 63,006 at 65,080-081 (1988); modified by, Kuparuk Transportation Co., 55 F.E.R.C. ¶ 61,122 at 61,382 (1991). Endicott Pipeline Co., 55 F.E.R.C. ¶ 63,028 at 65,163 (1991); Kenai Pipeline Co., P-91-2(23), P-85-1(31) at 24 (A.P.U.C. Oct. 29, 1993); Cook Inlet Pipeline Co., P-80-5(26), P-82-1(22), P-82-6(7) at 3-4 (A.P.U.C. Jan. 31, 1986). The holdings of these cases are uniform and unavoidable.

While the State will discuss the rule against retroactive ratemaking more fully in the next section, refunding surplus DR&R funds to shippers does not violate the rule. Several courts have observed that there is an exception to the rule for extraordinary and unforeseeable revenues and windfalls. See MCI Telecommunications v. Public Serv. Comm'n of Utah, 840 P.2d 765, 772, 775 (Utah 1992); Turpen v. Oklahoma Corporation Comm'n, 769 P.2d 1309 (Okla. 1988). Accordingly, the windfall exception prevents the application of the rule against retroactive ratemaking in this context.

In sum, DR&R funds left over after TAPS dismantlement is completed are windfalls which must be refunded to shippers. Refunding surplus dismantlement money to shippers is the only equitable result. The TAPS Carriers are made whole because the dismantlement expense was fully funded. The shippers are made whole because they

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2 contributed no more than was necessary and are compensated for the time-value of their
3 money.
4

5 **IV. WOULD A COMMISSION ORDER REQUIRING DEPOSIT**
6 **OF DR&R FUNDS IN A SEPARATE ACCOUNT BE**
7 **RETROACTIVE RATEMAKING?**

8 At the outset, the State reiterates that because the TAPS sinking fund is fully
9 funded and the 1985 TSA prohibits changes to the DR&R collection schedule, a
10 Commission order requiring deposit of DR&R funds in a separate account would not require
11 changing TAPS rates, either past or future. Therefore the rule against retroactive ratemaking
12 is not even triggered. Nevertheless, to the extent that the rule is somehow implicated,
13 review of the case law governing retroactive ratemaking in Alaska demonstrates that the rule
14 would not bar such a Commission order.

15 Courts in Alaska have had relatively few opportunities to address the rule
16 against retroactive ratemaking. In Far North Sanitation v. Alaska Pub. Util. Comm'n, 825
17 P.2d 867 (Alaska 1992), the Alaska Supreme Court held that the APUC must, in order to
18 avoid the proscription against retroactive rulemaking, conduct an investigation and hold a
19 hearing prior to determining that a rate is interim and subject to refund under the Alaska
20 Public Utilities Commission Act, AS 42.05. The Court explained that the rule against
21 retroactive ratemaking essentially requires rates to be prospective in nature. Id. at 872. The
22 court cited several cases which gave various rationales for the rule including utility
23 planning, investor confidence, utility credit rating and integrity of service. Id.
24
25

26 More recently, the Court addressed retroactive ratemaking in Alaska Pub. Util. Comm'n v. Municipality of Anchorage, 902 P.2d 783 (Alaska 1995). There the Court held that the APUC did not violate the rule against retroactive ratemaking when it ordered a

1
2 utility to refund charges for which tariffs had not been filed with the APUC. According to
3 the Court, such a refund did not impact the concerns of utility planning, investor confidence,
4 utility credit rating and integrity of service. Id. at 788.

5
6 Thus, a Commission order requiring an external fund could violate the rule
7 against retroactive ratemaking if it impacts utility planning, investor confidence, utility
8 credit rating and integrity of service. Alaska Pub. Util. Comm'n v. Municipality of
9 Anchorage, 902 P.2d at 788. Since the TAPS DR&R funds are already earmarked for
10 dismantlement, externalizing such funds are unlikely to impact investor confidence in the
11 TAPS Carriers, their credit rating or their integrity of service.

12
13 Such an order could conceivably impact utility planning, however. Since
14 1985, the TAPS Carriers have assumed that they could have use of the DR&R funds until
15 the actual dismantlement of TAPS. How this assumption has affected TAPS Carriers'
16 planning for the ultimate dismantlement of TAPS is unknown to the State. But the State
17 would be surprised if the TAPS Carriers did not maintain adequate reserves to fund known
18 future liabilities, including TAPS DR&R. For instance, in their discovery responses in
19 Docket P-97-4, the TAPS Carriers stated: "In accordance with governing accounting
20 standards and prudent management, each Carrier accrues a portion of its estimated DR&R
21 liability on its books each year." Docket P-97-4, TAPS Carriers' Second Responses to
22 Tesoro Alaska Petroleum Company's Discovery Requests, As Modified at 12 (April 30,
23 1999). Accordingly, it is rather doubtful in this context, that such a Commission order
24 would significantly impact utility planning.
25
26

Another way in which utility planning could be impacted by such a
Commission order is that placing DR&R funds in an external account could decrease the

1
2 rate of return earned by such funds which, in turn, could jeopardize the goal of fully funding
3 the dismantlement account. But as explained above, the TAPS DR&R sinking fund is now
4 fully funded (assuming no increase in the anticipated scope of the DR&R task) and need
5 only be inflation-proofed to remain so.
6

7 In sum, a Commission order requiring deposit of intrastate DR&R funds into
8 an escrow account does not violate the rule against retroactive ratemaking. Despite this
9 conclusion, as discussed above, while the rule against retroactive ratemaking does not
10 constitute a legal impediment to such a Commission order, for substantial policy reasons, the
11 State does not believe the Commission should order the TAPS Carriers to deposit DR&R
12 funds in an external account.
13

14 **V. WHAT IS THE APPROPRIATE TAX TREATMENT OF**
15 **THE DR&R FUNDS?**

16 The 1985 TSA assumes that since DR&R funds are treated as taxable income
17 by the TAPS Carriers and used for general corporate purposes, such funds are subject to
18 federal and state corporate income taxes. See APUC Docket P-86-2, Prepared Testimony of
19 Dr. Thomas Horst, Exhibit TOH-2 (Aug. 1, 1986). Moreover, the 1985 TSA assumes that
20 the TAPS Carriers cannot take a deduction for DR&R expenses until such expenses are
21 actually incurred. Id. Based on these two assumptions, the permissible amount of DR&R
22 provided by the 1985 TSA was "grossed-up" so that the after-tax amount of the DR&R
23 collection plus an imputed rate of interest would over time equal the anticipated expense of
24 DR&R.
25
26

The 1985 TSA's assumption regarding the non-deductibility of TAPS DR&R
expenses prior to the time such expenses were incurred had considerable basis. The Internal

Revenue Service has long prohibited the advance deduction of expenses. Prior to the construction of TAPS, the Treasury Regulations provided:

Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

Treas. Reg. § 1.461-1(a)(2) (1964), 29 Fed. Reg. 15753 (1964), 25 Fed. Reg. 11720 (1960).

In 1972, the Internal Revenue Service ruled:

[W]here there exists a contingency as to payment of an obligation, and such contingency relates to other than the ability of the obligor to pay, it cannot be said that the obligation is fixed within the meaning of section 1.461-1(a)(2) of the regulations. In such cases it cannot be said that all the events have occurred to fix the taxpayer's liability and obligation to pay, and, therefore, no deduction is currently allowable for Federal income tax purposes.

Rev. Rul. 72-34, 1972-1 C.B. 132. The 1964 wording of Treas. Reg. § 1.461-1(a)(2) remained unchanged until after 1984, when Congress explicitly made the regulatory "all events" test part of the Internal Revenue Code. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 91, 98 Stat. 494, 598-600 (1984) (creating § 461(h) of the Internal Revenue Code, 26 U.S.C. § 461(h)). Since 1984, the Internal Revenue Code has prohibited the deduction of an expense unless "economic performance" has occurred. See 29 U.S.C. § 461(h); see also Treas. Reg. § 1.461-1(a)(2) (1999); Treas. Reg. § 1.461-4(d)(7) (1999) (oil company cannot take deduction for dismantlement expenses associated with offshore platform and well fixtures until dismantlement is actually performed).

At all times relevant to TAPS (1974 through the present), therefore, the Internal Revenue Code and associated regulations have prohibited advance deductions for TAPS DR&R expenses because there is no question that TAPS DR&R is a contingent

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2 liability and the cost of it cannot be predicted with any accuracy.¹⁰ Indeed, there was never
3 even a dispute about tax-deductibility during the TAPS tariff litigation before the FERC.
4
5 There, the TAPS Carriers observed that there was no dispute that TAPS DR&R expenses
6 were not deductible until actually incurred. Trans-Alaska Pipeline System, F.E.R.C. Docket
7 OR78-1, Joint Initial Brief of Respondents on Phase II Non-Cost of Construction Issues at
8 325 (Sept. 3, 1985). The TAPS Carriers explained to the FERC that "the [TAPS Carriers]
9 pay taxes on the DR&R collections on a current basis, but the deductions will not be
10 available until far in the future." Id. at 327.
11

12 The State has recently learned, however, that the TAPS Carriers have taken
13 current-year deductions for TAPS DR&R expenses, despite the fact that such expenses have
14 yet to be incurred. In 1990, Exxon Corporation filed a public petition in U.S. Tax Court in
15 which it stated as follows:
16

17 In a July 20, 1988, Closing Agreement under section 7121 of the
18 Code, the Commissioner and the TAPS participants, including
19 Exxon Pipeline, agreed to the proper section 162 deduction for
20 TAPS dismantlement and restoration costs. Although Exxon
21 Pipeline's ownership interest during 1980, 1981, and 1982 was
22 20.3378 percent, the Commission used a 20 percent ownership
23 interest in determining the section 162 deduction for
24 dismantlement and restoration costs for those taxable years. The
25 Commissioner, in allowing Exxon Pipeline's share of the section
26 162 deduction on the basis of a 20 percent interest for 1980, 1981,
and 1982, erroneously did not follow the Closing Agreement.

U.S. Tax Court, Exxon Corp. v. Commissioner, Docket 18432-90, Petition at 146 (Aug. 16,
1990) (emphasis added and attached as Exhibit A).

¹⁰ "Nobody knows today when DR&R is going to be required, or how much it will cost. The chance it will cost \$872.1 million in 1997 [sic] dollars is infinitesimal." Remarks of TAPS Counsel, RCA Docket P-97-7, Tr. 18 (Sept. 10, 1999). \$872.1 million in 1977 dollars

Exxon's statement in its U.S. Tax Court petition surely does not provide all of the relevant details. But there have been no changes in federal tax law which would permit an advance deduction for TAPS DR&R expenses. The State is currently evaluating the ramifications of this discovery. The issue is by no means insignificant—the State's preliminary estimates suggest that had the 1985 TSA taken current-year deductibility into account, the schedule of permissible DR&R allowances could have been a fraction of what the schedule currently provides. But the State needs more information before it can arrive at any firm conclusions. Accordingly, the State is unable to provide a complete response to the Commission's question at this time. The State believes that it would be appropriate for the Commission to investigate this issue.

VI. CONCLUSION

For the reasons set forth above, the Commission should not order the TAPS Carriers to deposit DR&R funds in an external account. The RCA and the FERC must ultimately order refunds of surplus DR&R funds. Finally, the advance tax-deductibility of the TAPS DR&R expense is an important issue that warrants further inquiry. The State requests that the Commission investigate this issue.

is the projected cost of TAPS DR&R assumed by the 1985 TSA. See Trans-Alaska Pipeline System, F.E.R.C. Docket OR78-1, State of Alaska's Explanatory Statement at 30-31.

DATED: January 10, 2000

BRUCE M. BOTELHO
ATTORNEY GENERAL

By: Michael A. Barnhill
Michael A. Barnhill
Assistant Attorney General
Alaska Bar No. 9311063

VERIFICATION

Michael A. Barnhill, being duly sworn, states:

(1) That he is an attorney for the State of Alaska, Department of Law, in Juneau, Alaska, and that he prepared the attached State of Alaska's Brief on DR&R Legal Issues.

(2) That he declares under oath that he has read the foregoing document and believes all the statements made in the document are true.

Dated: January 10, 2000

Michael A. Barnhill
Michael A. Barnhill

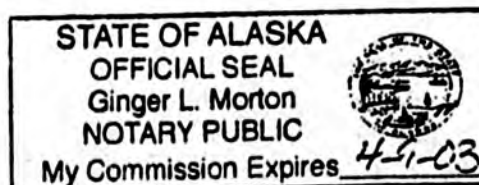
SUBSCRIBED and SWORD TO before me this 10th day of January, 2000.

Ginger L. Morton
Notary Public, State of Alaska
My commission expires: 4-9-03

The undersigned certifies that a true and correct copy of the attached documents were mailed on this date to:

see attached list

Name Ginger Morton Date 1-10-00



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UNITED STATES TAX COURT

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ATTORNEY GENERALS OFFICE
JUNEAUUNITED STATES
TAX COURTUNITED
TAX COURT

EXXON CORPORATION AND AFFILIATED COMPANIES,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.

MAIL CLERK	10
ADMISSIONS	10
RECORDED & SERVED	10
PUB. FILES	10

PETITION

The Petitioners hereby petition for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue ("Commissioner") in his Notice of Deficiency, dated July 16, 1990. As the basis for their action, Petitioners allege as follows:

1. Exxon Corporation ("Exxon") is a corporation organized under the laws of New Jersey. (Employer Identification No. 13-5409005). It has its principal place of business at 1251 Avenue of the Americas, New York, New York 10020, which is also its mailing address. Exxon is the common parent of an affiliated group of corporations which includes all of the Petitioners. Exxon timely filed consolidated corporate income tax returns for the affiliated group's taxable years ended December 31, 1980, December 31, 1981, and December 31, 1982, with the Internal Revenue Service, Manhattan District, in New York, New York.

Exhibit A page 1 of

SERVED AUG 17 1990

(123) During 1980, EGSI incorrectly characterized certain asset retirements under CLADRS, and it is entitled to decrease its gains under section 1245 of the Code to reflect the proper characterization of the asset retirements under CLADRS.

(124) Adjustments by the Commissioner during audits prior to the 1980-1982 audit resulted in the capitalization of amounts which had previously been charged to expense. As a result, EGSI is entitled to increased depreciation deductions for 1980, 1981, and 1982.

Exxon Pipeline

(125) During 1977, Exxon Pipeline, through its participation in TAPS, installed a pipeline and related facilities on Alaska properties. In a July 20, 1988, Closing Agreement under section 7121 of the Code, the Commissioner and the TAPS participants, including Exxon Pipeline, agreed to the amount of the proper section 162 deduction for TAPS' dismantlement and restoration costs. Although Exxon Pipeline's ownership interest during 1980, 1981, and 1982 was 20.3378 percent, the Commissioner used a 20 percent ownership interest in determining the section 162 deduction for dismantlement and restoration costs for those taxable years. The Commissioner, in allowing Exxon Pipeline's share of the section 162 deduction on the basis of a 20 percent interest for 1980, 1981, and 1982, erroneously did not follow the Closing Agreement.

Rep. Whitaker

R.C.A.
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STATE OF ALASKA

BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Patricia M. DeMarco
James S. Strandberg

In the Matter of the Petition of TESORO ALASKA)
PETROLEUM COMPANY for an Investigation into)
the Amounts Collected by AMERADA HESS)
PIPELINE CORPORATION; ARCO)
TRANSPORTATION ALASKA, INC.; BP)
PIPELINES (ALASKA) INC.; EXXON PIPELINE)
COMPANY; MOBIL ALASKA PIPELINE)
COMPANY; PHILLIPS ALASKA PIPELINE)
CORPORATION; and UNOCAL PIPELINE)
COMPANY for Dismantling, Removal and Restoration)
of the Trans Alaska Pipeline System)

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ATTORNEY GENERAL'S OFFICE
JUNEAU

STATE OF ALASKA'S REPLY RE: DR&R LEGAL ISSUES

As the Commission has seen from the opening briefs there is little common agreement among the various parties with respect to the legal issues for which the Commission sought briefing. In some respects the State agrees with the shippers' positions, and in some respects the State agrees with the TAPS Carriers' positions. The State will address the various arguments below.

I. THE COMMISSION HAS JURISDICTION ONLY OVER THE DR&R FUNDS COLLECTED THROUGH THE INTRASTATE TARIFF

As the State explained in its opening brief, the Commission only has jurisdiction over DR&R funds (and associated earnings) collected through the intrastate tariff. See State's Brief on DR&R Legal Issues at 3-8. Because the Interstate Commerce Act (ICA) governs interstate pipeline rates and practices, the Commission is preempted from asserting jurisdiction

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3 over DR&R funds (and associated earnings) collected through the interstate tariff. Id.; ICA
4 section 15(1); AS 42.06.150.

5 The Public Advocacy Section's argument roughly parallels the State's and
6 agrees with the State's conclusion regarding jurisdiction. See Public Advocacy Section Brief in
7 Response to Commission Questions at 2-5. The State shares the Public Advocacy Section's
8 concern that an assertion of jurisdiction by the Commission over interstate tariffs would indeed
9 be "vulnerable." Id. at 5.
10

11 The TAPS Carriers also agree with the State's conclusion regarding the
12 Commission's jurisdiction over interstate DR&R funds. The TAPS Carriers, however, raise
13 multiple arguments against an assertion of jurisdiction over all the DR&R funds by the
14 Commission. The State generally agrees with each of the TAPS Carriers' arguments, except
15 one. The TAPS Carriers contend that an assertion of jurisdiction by the Commission over
16 interstate DR&R funds would violate the federal "filed rate doctrine." See TAPS Carriers'
17 Initial Brief on the Commission's Questions at 12-14. The State disagrees—neither the filed
18 rate doctrine nor the rule against retroactive ratemaking is triggered by the potential excess of
19 DR&R funds and the concomitant requirement that the TAPS Carriers ultimately refund such
20 excess to shippers. In any event, this is not a question the Commission need concern itself with
21 at this time. The law is clear that the Interstate Commerce Act preempts an exercise of
22 jurisdiction by the Commission over interstate DR&R funds without resort to the filed rate
23 doctrine and the rule against retroactive ratemaking.
24
25

26 On the other hand, Tesoro and Williams urge the Commission to assert
jurisdiction over all DR&R funds and associated earnings, including funds collected through
the interstate tariffs. Tesoro claims that the Commission has jurisdiction over interstate DR&R

1 funds because the FERC does not have abandonment authority under the Interstate Commerce
2 Act. See Tesoro's Opening Brief on DR&R Matters at 17-21. But as the State demonstrated in
3 its brief, despite the lack of abandonment authority, the FERC does have jurisdiction over
4 interstate rates and practices, and has already asserted jurisdiction over the issue of how TAPS
5 DR&R funds are preserved for the future. See State's Brief on DR&R Legal Issues at 6-8.
6

7 Williams contends that the lack of explicit FERC authority over DR&R
8 accounting means that the Commission can assert jurisdiction over interstate DR&R funds. See
9 Initial Brief of Williams Alaska Petroleum, Inc. at 2-3. But Williams ignores the fact that the
10 FERC has already asserted jurisdiction under section 15(1) of the ICA over TAPS, Endicott
11 and Kuparuk DR&R accounting issues, including whether to impose an external fund
12 requirement. See State's Brief on DR&R Legal Issues at 7.
13

14 Neither Tesoro nor Williams offers anything in the way of case law or statute
15 that squarely supports the proposition that the Commission may assert jurisdiction over
16 interstate DR&R funds. See Tesoro's Opening Brief on DR&R Matters at 17-21; Initial Brief
17 of Williams Alaska Petroleum, Inc. at 2-5. Instead, Tesoro concedes that such an assertion of
18 jurisdiction would be a "closer call" and a "closer question." See Tesoro's Opening Brief on
19 DR&R Matters at 10, 13.
20

21 The Commission should resist Tesoro's and Williams' suggestion that it take
22 this docket on a jurisdictional lark. Such a detour would ultimately serve no beneficial
23 purpose—it would tie this docket up in needless litigation, probably for a considerable period
24 of time. For the past 22 years, the FERC has been a readily available forum to address
25 interstate TAPS DR&R issues—Tesoro and Williams may raise their concerns regarding the
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3 interstate DR&R funds there. This Commission cannot assert jurisdiction over interstate
4 DR&R funds.

5 **II. THE APUC'S APPROVAL OF THE TAPS SETTLEMENT**
6 **METHODOLOGY DOES NOT PRECLUDE THE COMMISSION'S**
7 **CONSIDERATION OF THE REQUIREMENT OF ESTABLISHING**
8 **AN EXTERNAL FUND FOR DR&R--BUT THE COMMISSION**
9 **SHOULD NOT REQUIRE SUCH A FUND**

10 For various reasons, all of the parties except the TAPS Carriers agree that the
11 Commission may consider imposition of an external fund for DR&R. As the State explained in
12 its opening brief, the APUC's prior approvals of the TAPS Settlement Methodology do not
13 preclude consideration of an external fund requirement. See State's Brief on DR&R Legal
14 Issues at 8-12. Because of unanticipated decreases in rates of inflation and taxes, the TAPS
15 DR&R "sinking fund" became fully funded ten years earlier than anticipated. Id. at 10-11.
16 Placing the collected and earned DR&R funds into an external account would not result in the
17 need to adjust either past or future rates. Nevertheless, the State does not believe that an
18 external fund is warranted as a policy matter at this time. Id. at 11-12.

19 The TAPS Carriers contend at length that imposition of an external fund
20 requirement would violate the APUC's past orders. See TAPS Carriers' Initial Brief on the
21 Commission's Questions at 19-38. The State agrees with the TAPS Carriers' ultimate
22 conclusion that there should not be an external fund for TAPS DR&R. But the State disagrees
23 with TAPS Carriers' multiple legal arguments that the Commission may not impose an external
24 DR&R fund.
25

26 Currently the State sees no reason to require an external fund for intrastate
DR&R funds. But it is impossible to predict how circumstances might change over the next
several decades—it is not inconceivable that there may come a time when the State's interests

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3 will require such an external fund. The Commission should therefore be wary of ruling that it
4 is forever precluded from requiring an external fund because the APUC failed to do so in 1987.

5 **III. THE TAPS CARRIERS MUST ULTIMATELY REFUND**
6 **EXCESS DR&R FUNDS**

7 As the State explained in its opening brief, the TAPS Carriers must ultimately
8 refund excess DR&R funds to shippers.¹ See State's Brief on DR&R Legal Issues at 15. Both
9 the FERC and the APUC have repeatedly held that excess DR&R funds must be refunded. Id.
10 Any other result would be unfair to the shippers and would allow the TAPS Carriers to earn an
11 impermissible profit on the expense of TAPS DR&R.

12
13 The TAPS Carriers cite the dissents of two previous APUC Commissioners
14 (Knowles and Foster) in support of the notion that the 1985 Interstate TAPS Settlement
15 Agreement ("1985 TSA") compensates the TAPS Carriers for the risk of undercollections by
16 allowing the TAPS Carriers to keep overcollections. See TAPS Carriers' Initial Brief on the
17 Commission's Questions at 39-40. Review of the 1985 TSA demonstrates that this
18 interpretation is incorrect. The 1985 TSA provides a schedule of permissible annual DR&R
19 collections and nothing more. The 1985 TSA is silent on the issue of refunds and does not
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¹ Note that tariff refunds to shippers of State royalty-in-kind (RIK) oil may be subject to a RIK price adjustment claim by the State. This is because, in general, the price of State RIK oil is based on a market price less the cost of transportation. If the RIK shipper receives a transportation cost refund, this has the effect of retroactively increasing the sale price of the RIK oil by the amount of the refund. Depending on the terms of the particular RIK contract, the State may claim up to 100% of any transportation cost refund received by an RIK shipper.

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3 explicitly or implicitly allocate risk.²

4 Notably, at no place in the entire record of Docket P-86-2 did either the TAPS
5 Carriers or the State suggest to the Commission that the 1985 TSA allocated DR&R risks in
6 the manner currently suggested by the TAPS Carriers. Moreover, a dissent is neither evidence
7 nor persuasive authority. The TAPS Carriers' reliance on Commissioners Knowles' and
8 Foster's dissents is misplaced.
9

10 Because the DR&R sinking fund is now fully funded, the TAPS Carriers have
11 practically no risk for a DR&R undercollection. No further risk allocation is necessary in order
12 to achieve an equitable result for shippers, the State and the TAPS Carriers.

13 **IV. A COMMISSION ORDER REQUIRING DEPOSIT OF DR&R**
14 **FUNDS IN A SEPARATE ACCOUNT WOULD NOT BE**
15 **RETROACTIVE RATEMAKING**

16 As the State explained in its opening brief, the rule against retroactive
17 ratemaking would not be triggered by the imposition of an external fund requirement, because
18 rates would not change. See State's Brief on DR&R Legal Issues at 11, 16. Assuming for the
19 sake of argument that rates would change, however, the rule against retroactive ratemaking as
20 articulated by the Alaska Supreme Court would not be violated. Id. at 16-18.

21 Notably, the rule against retroactive ratemaking adopted by the Alaska Supreme
22 Court is quite different than that described by the TAPS Carriers. At multiple places in their
23 brief, the TAPS Carriers suggest that a rigid rule against retroactive ratemaking in Alaska is
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26 ² Note that the 1985 TSA explicitly did not settle all issues in the TAPS tariff
litigation: "The parties do not intend that this Agreement, its term, or the
methodology it employs, should have any precedential effect on tariff ratemaking . . .
for any aspect of the TAPS Proceeding not settled by this Agreement." Introductory
Statement, 1985 TSA.

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3 required by the commission ratemaking provision of the Alaska Pipeline Act.³ This provision
4 provides:

5 When the commission, after an investigation and hearing,
6 finds that a rate demanded, observed, charged, or collected by
7 a pipeline carrier for a service, subject to the jurisdiction of the
8 commission, or that a classification, rule, regulation, practice,
9 or contract affecting the rate, is unjust, unreasonable, unduly
10 discriminatory or preferential, the commission shall determine
11 a just and reasonable rate, classification, rule, regulation,
12 practice, or contract to be observed or allowed and shall
13 establish it by order.

14 AS 42.06.410(a)(emphasis added). The TAPS Carriers correctly observe that this
15 provision was patterned after the ratemaking provision in the Alaska Public Utilities
16 Regulatory Act, AS 42.05.431(a). The operative language in both of these
17 provisions is the phrase "to be observed or allowed." The TAPS Carriers mistakenly
18 contend that this language requires Commission ratemaking under these provisions
19 to be purely prospective. The legislative history of these provisions demonstrates
20 that the Alaska Legislature did not intend such a result.

21 In 1970, the Alaska Legislature repealed the Alaska Public Service
22 Commission Act, former AS 42.05, and replaced it with what is now known as the
23 Alaska Public Utilities Regulatory Act, AS 42.05. See ch. 113, SLA 1970. The
24

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26 ³ The TAPS Carriers also assert that the federal rule against retroactive ratemaking prohibits
the placement of interstate DR&R funds in an external fund. See TAPS Carriers' Initial Brief
on the Commission's Questions at 40-43. The State disagrees, but since the Commission may
not exercise jurisdiction over interstate DR&R funds, the State does not need to address this
argument at this time.

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3 ratemaking provision in the Alaska Public Service Commission Act, subsequently
4 replaced in 1970 by AS 42.05.431(a), provided as follows:

5 Whenever, upon an investigation, the commission shall find
6 any rates, tolls, charges, schedules or joint rate or rates, to be
7 unjust, unreasonable, insufficient or unjustly discriminatory,
8 or to be preferential or otherwise in violation of any of the
9 provisions of this Act, the commission shall determine, and by
10 order fix just and reasonable rates, tolls, charges, schedules or
11 joint rates to be imposed, observed and followed in the future
12 in lieu of those found to be unjust, unreasonable, insufficient
13 or unjustly discriminatory or preferential or otherwise in
14 violation of any of the provisions of this Act.

15 See former AS 42.05.520, sec. 45, ch. 199, SLA 1959 (emphasis added). The essential
16 difference between former AS 42.05.520 and the current AS 42.05.431(a) and AS 42.06.410(a)
17 is the phrase "in the future." From 1959 to 1970, then, the Alaska ratemaking statute required
18 that commission ratemaking be prospective, i.e., only apply "in the future." In 1970, however,
19 the Alaska Legislature deleted the phrase "in the future" from the ratemaking provision and thus
20 repealed the prospective requirement for commission ratemaking.

21 When the Alaska Supreme Court first addressed the rule against retroactive
22 ratemaking in Far North Sanitation v. Alaska Pub. Util. Comm'n, 825 P.2d 867 (Alaska 1992),
23 the court obviously relied on the common law of retroactive ratemaking as expressed by courts
24 of other jurisdictions, rather than a close examination of the Alaska ratemaking statute and its
25 legislative history. Id. at 872. In any event, as the State demonstrated in its opening brief, the
26 Court's articulation of the common law rule against retroactive ratemaking is substantially less
rigid than the TAPS Carriers' articulation of the rule, which is based on a mistaken
interpretation of AS 42.05.431(a) and AS 42.06.410(a).

The State anticipates that the TAPS Carriers will ultimately contend that the mere words "to be observed" requires prospective ratemaking regardless of the legislative history of AS 42.05.431(a). In reviewing ratemaking provisions from other jurisdictions which employ the phrase "to be thereafter observed" (as opposed to merely "to be observed"), one commentator has rejected the view that such language requires prospective ratemaking only. See Stefan H. Kreiger, The Ghost of Regulation Past: Current Application of the Rule of Retroactive Ratemaking in Public Utility Proceedings, 1991 U. Ill. L. Rev. 983, 1032-35 (1991). According to Professor Kreiger, this "dubious" interpretation of ratemaking provisions is completely inconsistent with the broad legislative delegation of ratemaking powers to utility commissions. Id. at 1034.⁴ Professor Kreiger concludes that a "close reading of the relevant enabling statutes discloses no clear legislative intent to forbid retroactive ratemaking." Id. at 1035.

Arguably, after the Alaska Legislature deleted the words "in the future" from the ratemaking provision in 1970, the rule against retroactive ratemaking should no longer exist in Alaska, at least as a matter of statutory interpretation. But in any event, as the State explained in its opening brief, the common law version of the rule adopted by the Alaska Supreme Court in Far North Sanitation does not pose an obstacle to the imposition of an external DR&R fund. See State's Brief on DR&R Legal Issues at 16-18. The Commission,

⁴ Indeed, the Alaska Supreme Court recognized such powers in Far North Sanitation: "The legislature granted APUC broad powers to accomplish its purposes, and further provided that those powers should be liberally interpreted. AS 42.05.141(a)(1)." Far North Sanitation, 825 P.2d at 872 (compare AS 42.06.140(a)(1)).

however, should not impose such a requirement at this time.⁵

V. THE COMMISSION SHOULD INVESTIGATE TAPS DR&R
FEDERAL TAX DEDUCTIONS

The State recently discovered that despite the 1985 TSA's assumption that the TAPS Carriers could not take deductions for the TAPS DR&R expense until the expense was actually incurred, the TAPS Carriers have taken such deductions. See State's Brief on DR&R Legal Issues at 20-21. In 1988, the I.R.S. entered into a settlement agreement with the TAPS Carriers that permitted such tax deductions. The TAPS Carriers produced an excerpt of this agreement in Docket P-97-4—this excerpt is attached as Exhibit A, which is sealed pursuant to the protective order in this docket.⁶ See Docket P-97-7, Order No. 17. The time period over

→ see pg 2 of 4
exhibit B

⁵ In the retroactive ratemaking section of their brief, the TAPS Carriers also take the opportunity to suggest that the DR&R funds are their own "private property." See TAPS Carriers' Initial Brief on the Commission's Questions at 45-48. The TAPS Carriers are absolutely wrong—DR&R funds are monies collected from third party shippers necessary to restore and rehabilitate land that belongs to the State of Alaska and the United States. Excess DR&R funds must be refunded to the shippers. Of all of the parties with an interest in DR&R funds, the TAPS Carriers have the least valid claim to DR&R funds as their own private property. The TAPS Carriers' citation to Phillips v. Washington Legal Foundation, 524 U.S. 156, 118 S.Ct. 1925 (1998), is precisely on point: Just as lawyers hold clients' private property in trust, the TAPS Carriers are holding the private property of the State of Alaska, the United States, and shippers in the form of DR&R funds in trust until the time comes to restore and rehabilitate the TAPS right-of-way and refund the excess to shippers.

⁶ The State has been advised by a third party that Exxon introduced this 1988 Closing Agreement as a trial exhibit in a proceeding before the U.S. Tax Court in 1998. The trial exhibit was apparently not sealed by the U.S. Tax Court and is available for public inspection. As the State has explained in a separate pleading, the trial record is presently unavailable for public inspection because the U.S. Tax Court judge is preparing the decision in that case. See State's Preliminary Opposition to the TAPS Carriers' Petition to Classify Records as Confidential at 3, Docket P-97-7 (January 19, 2000). As soon as the trial record again becomes publicly available, the State will immediately seek to confirm that Exxon made the 1988 Closing Agreement a public document and advise the Commission accordingly. During the interim, the State will treat this document as confidential.

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3 which the I.R.S. permitted such tax deductions may be found on p. 4 of Exhibit A (labeled
4 "Page 3 of 15, RTSMTX 02644").

5 The State is currently attempting to reconcile the representations made by the
6 TAPS Carriers and their experts in the TAPS tariff litigation that federal income tax deductions
7 for the TAPS DR&R expense "will not be available until far in the future,"⁷ with the reality
8 that the TAPS Carriers sought and obtained such tax deductions. The State has not drawn any
9 conclusions, however, and needs further information before it can do so. The State reiterates
10 its request that the Commission conduct a thorough investigation into this matter.
11

12 DATED: February 7, 2000

13
14 BRUCE M. BOTELHO
15 ATTORNEY GENERAL

16
17 By: Michael A. Barnhill
18 Michael A. Barnhill
19 Assistant Attorney General
20 Alaska Bar No. 9311063
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ATTORNEY GENERAL, STATE OF ALASKA
DIMOND COURTHOUSE
P.O. BOX 110300, JUNEAU, ALASKA 99811
PHONE: 465-3600

⁷ See Exhibit B at 4 (Excerpt from Trans-Alaska Pipeline System, F.E.R.C. Docket OR78-1, Joint Initial Brief of Respondents on Phase II Non-Cost of Construction Issues pp. 1, 325-27 (Sept. 3, 1985)).

VERIFICATION

Michael A. Barnhill, being duly sworn, states:

(1) That he is an attorney for the State of Alaska, Department of Law, in Juneau, Alaska, and that he prepared the attached State of Alaska's Reply Brief Re: DR&R Legal Issues.

(2) That he declares under oath that he has read the foregoing document and believes all the statements made in the document are true.

Dated: February 7, 2000

Michael A. Barnhill
Michael A. Barnhill

SUBSCRIBED and SWORD TO before me this 7th day of February, 2000.

Elena B. Corpuz
Notary Public, State of Alaska
My commission expires: 8/19/2001



ATTORNEY GENERAL, STATE OF ALASKA
DIMOND COURTHOUSE
P.O. BOX 110300, JUNEAU, ALASKA 99811
PHONE: 465-3600

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Trans Alaska Pipeline System)

Docket No. OR78-1
(Phase II Non-cost)

JOINT INITIAL BRIEF OF RESPONDENTS
ON PHASE II NON-COST OF CONSTRUCTION ISSUES

September 3, 1985

TSM_009394

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rate must be examined to determine whether, on the whole, it is just and reasonable. (Jiorle, Tr. 265/40,834-35).

(5) Inflation Rate

Respondents' inflation rate of 6.0 percent should be accepted as reasonable. It is within the range of the rates of inflation recommended by the other witnesses testifying on the subject. In fact it is significantly lower than the rates used by the APUC Staff (7.0 percent) (Bartschi, Exhibit IINC-5-0 at 12) and the State of Alaska (7.13 percent) (Ileo, Exhibit IINC-4-0 at 21).

Dr. Crichfield's projected inflation rate is based on an examination of historical data and a consideration of future events likely to affect the rate of inflation. (Crichfield, Exhibit IINC-8-0 at 5-6; Exhibit IINC-8-3). In contrast, FERC Staff witness Jiorle does not even attempt to support his inflation figure of 5.5 per cent, stating only that it "is representative of most current forecasts." (Exhibit IINC-6-0 at 9). He does not identify the forecasts to which he refers, nor does he explain their basis.

(6) Tax Treatment Of DR&R Collections

No witness contests that DR&R collections are not deductible when received by the respondent. Respondents will therefore be required to pay income taxes on these amounts. If the respondents were able to use deductions of DR&R costs at the time DR&R was performed to affect income, DR&R collections

- 326 -

could be classified as a timing difference, and the difference normalized. By definition, however, DR&R will not take place until the useful life of TAPS is at an end and shippers are no longer using the line. It is doubtful that the respondents will have sufficient income at that time to use the DR&R deduction fully. (Tarlson, Exhibit IINC-9-0 at 23-24). To the extent that DR&R collections are premised on tax timing differences, therefore, the respondents will fail to recover a portion of the cost of DR&R. Under virtually identical circumstances, the APUC has treated DR&R collections as giving rise to a permanent difference, Cook Inlet Pipe Line Co., 66 P.U.R.4th 77, 98-99 (APUC 1985).

Witnesses Bertschi and Ileo suggest that the tax benefits of deducting the cost of DR&R should be taken into account notwithstanding the improbability that the respondents will have sufficient income to use them because the respondents' parents will have sufficient income. (Bertschi, Exhibit IINC-5-3 at 11-13; Ileo, Exhibit IINC-4-11 at 10). This erroneous approach appears to proceed from the incorrect premise that the parent companies, and not the respondents, bear the obligation to carry out DR&R. (E.g., Ileo, Exhibit IINC-4-11 at 10). As is explained in section VI.D.1., supra, however, the obligation resides with the respondents. Moreover, attributing to the respondents tax benefits that might accrue to their parents violates the standalone principle. (Tarlson, Exhibit IINC-9-0 at 25-26; see also section IV.A.5.c., supra). Just as the respondents' revenue

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requirements should not be increased to reflect affiliated companies' tax losses, they should not be decreased because of favorable tax treatment enjoyed by affiliates. (Id.).

Witness Jiorle contends that DR&R creates a timing difference, but does not follow through on his own hypothesis. He merely assumes that the tax burden of the DR&R collections will be offset by the benefit of the deduction when DR&R is performed. (Jiorle, Exhibit IINC-6-0 at 17). This ignores the fact that the respondents pay taxes on the DR&R collections on a current basis, but the deductions will not be available until far in the future. The time value of this difference must be taken into account. (Tarlson, Exhibit IINC-9-0 at 24). He also fails to allow for taxes on the earnings of the DR&R amounts that are collected. (Id.).

For the foregoing reasons the FERC ought to include an allowance for DR&R in each respondent's rates calculated in accordance with the testimony of Mr. Hildahl.

TSM_009748

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Bernie Smith
Patricia M. DeMarco
Will Abbott
James S. Strandberg

In the Matter of the Correct Calculation and Use of)
Acceptable Input Data To Calculate the 1997, 1998,)
1999, and 2000 Tariff Rates for the Intrastate)
Transportation of Petroleum over the Trans Alaska)
Pipeline System Filed by AMERADA HESS PIPELINE)
CORPORATION; ARCO TRANSPORTATION)
ALASKA, INC.; BP PIPELINES (ALASKA) INC.;)
EXXON PIPELINE COMPANY; MOBIL ALASKA)
PIPELINE COMPANY; PHILLIPS ALASKA PIPELINE)
CORPORATION; and UNOCAL PIPELINE)
COMPANY and the Protest by TESORO ALASKA)
PETROLEUM COMPANY of the 1997 Tariff Rates)
_____)

P-97-4

ORDER NO. 79

ORDER GRANTING MOTION FOR SUMMARY DISPOSITION AND
ESTABLISHING FILING SCHEDULE

BY THE COMMISSION:

This Order addresses Tesoro Alaska Petroleum Company (Tesoro's) First Motion for Summary Disposition (Motion), filed on March 15, 1999, with the Alaska Public Utilities Commission (APUC), this Commission's predecessor. The APUC opened this Docket to consider Tesoro's protest of the 1997 annual Trans Alaska Pipeline System (TAPS) rates filed by AMERADA HESS PIPELINE CORPORATION,

ARCO TRANSPORTATION ALASKA, INC., BP PIPELINES (ALASKA) INC., EXXON PIPELINE COMPANY, MOBIL ALASKA PIPELINE COMPANY, PHILLIPS ALASKA PIPELINE CORPORATION, and UNOCAL PIPELINE COMPANY (collectively, TAPS Carriers or Carriers). The APUC ordered that the Docket also encompass the correct calculation of rates and the use of acceptable input data to calculate rates under the TAPS Settlement Methodology (TSM).¹ As the TAPS Carriers filed annual rates for 1998, 1999, and 2000, the APUC or this Commission suspended those rates and incorporated its investigation of them into this Docket.²

At oral argument Tesoro described its Motion as one requesting summary disposition because the TAPS Carriers failed to prove that the 1997 and 1998 TAPS rates were just and reasonable. The parties³ have presented a variety of arguments in response to Tesoro's Motion.

¹Order P-86-2(61)/ P-92-2(30)/ P-94-1(36)/ P-95-1(16)/ P-97-4(1)/ P-97-5(1)/ P-97-6(1)/ P-97-7(1), dated June 27, 1997. TSM is the methodology contained in the interstate TAPS Settlement Agreement between the State of Alaska (State) and the TAPS Carriers dated June 28, 1985, adopted to calculate intrastate rates in the intrastate TAPS Settlement Agreement between the State and the TAPS Carriers dated April 7, 1986.

²The 1998 rates were added by Order P-94-1(46)/P-95-1(26)/P-97-4(12)/ P-97-6(11)/P-97-7(11)/P-97-9(5), dated December 26, 1997; the 1999 rates were added by Order P-94-1(54)/P-95-1(33)/P-97-4(35)/P-97-6(20)/P-97-7(21), dated December 28, 1998 (Order Suspending 1999 Rates); and the 2000 rates were added by Order P-94-1(75)/P-97-4(64)/P-97-6(41)/P-97-7(46), dated December 17, 1999.

³The parties to this Docket are the TAPS Carriers, Tesoro, Williams Alaska Petroleum, Inc. (Williams), the State, the Public Advocacy Section of the Commission, and BP Exploration (Alaska), Inc. (BPXA). Williams and the Public Advocacy Section supported the Motion. The TAPS Carriers and the State opposed the Motion. BPXA took no position on the Motion.

This Order discusses only those arguments that pertain to whether the Commission should grant Tesoro's motion for summary disposition with respect to the 1997 and 1998 TAPS rates. To determine whether summary disposition should be granted, the Commission must: (1) identify which party carries the burden of proof; (2) define the test for summary disposition; (3) establish how to determine whether rates are just and reasonable; and (4) apply the evidence presented to that standard.

Burden of Proof

The APUC explicitly stated in this proceeding that the TAPS Carriers bear the burden of proving that TAPS rates are just and reasonable. At the May 5, 1998, prehearing conference, the APUC explained:

[It] seems that it may be the view of the TAPS Carriers that a challenge to TSM is a challenge to established methodology and that, therefore, the challenger must submit their evidence first. The Commission wishes to make it clear that the TAPS Carriers are the ones who need to justify their rates as though TSM had not been approved. This was made clear, we think, in the order that the Commission issued in 1993 where they said that each annual filing would be a revised rate under AS 42.06.400. And, therefore, it is the TAPS Carriers that need to make their filing first to justify their rates in whatever way they choose to justify their rates.

Prehearing Conference Tr. at 66 (May 5, 1998). The APUC later noted that it had previously announced " . . . at the May 5, 1998, prehearing conference that the TAPS Carriers must make an initial filing in this proceeding justifying their intrastate rates." Order P-97-4 (24), dated July 8, 1998, p. 2.

The 1993 order to which the APUC referred at the May 5, 1998, prehearing conference was its order accepting TSM in the absence of a protest, (Order P-86-2(41)/P-86-3(7)/P-90-1(12), dated October 29, 1993) (Order Accepting

Settlement). *Re Amerada Hess Pipeline Corporation*, 13 APUC 448 (1993). In that Order the APUC stated at p. 21: "Each new rate filed by the TAPS Carriers under the Intrastate Settlement Agreement is considered to be a revised tariff filing under AS 42.06.400. The filing is subject to the same standards and procedures to which it would have been subject if the Intrastate Settlement Agreement had not been accepted." Under AS 42.06.400(d) "[o]ne who initiates a change in existing tariffs bears the burden of proving the reasonableness of the change." With regard to the 1997, 1998, 1999, and 2000 rates, the TAPS Carriers have revised the existing tariffs each year.⁴ Therefore, the Carriers bear the burden of proving each year that the rates are reasonable.

Over Tesoro's opposition, the APUC ordered that the TAPS Carriers case-in-chief could be made on the basis of composite and proxy data in order to permit the Commission to make an initial determination of whether the rates at issue are just and reasonable. The APUC stated in Order P-97-4(24), dated July 8, 1998:

The TAPS Carriers may use reasonable proxies subject to their right to substitute carrier-specific data and projections at a later stage of the proceeding, if they wish. Depending on the Commission's assessment of the initial evidentiary filing and input of the other parties to the proceeding the Commission may require the submission of carrier-specific data and projections.

After the TAPS Carriers and the State filed their testimony, APUC Chairman Cotten explained to Tesoro's counsel at a March 3, 1999 prehearing conference:

⁴The Commission recognizes that the TAPS Carriers have had the opportunity to file testimony regarding the 1997 and 1998 TAPS rates only.

Finally, I know at one of our previous hearings you had preferred that we manage this case as though it were a case designed to set rates. I think the Commission didn't quite get to where you wanted to go on that. I think we described it in some terms as an ability for us to view a gross test to see if the rates were unjust.

Prehearing Conference Tr. at 271 (March 3, 1999). Thus, as explained by the APUC in this proceeding and under AS 42.06, the TAPS Carriers bear the burden of proving that TAPS rates are just and reasonable.

Standard for Summary Disposition

Under Alaska Civil Rule 56 any party is entitled to summary judgment if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and the party is entitled to judgment as a matter of law. In deciding summary judgment motions, "[a]ll reasonable inferences of fact from proffered materials must be against the moving party and in favor of the non-moving party." *Wright v. State*, 824 P.2d 718, 720 (Alaska 1992). The burden is on the party moving for summary judgment to establish the absence of a material issue of fact. The party opposing the motion for summary judgment need not establish that it will ultimately prevail, but only that there exists a genuine issue of fact to be litigated. *Alaska Rent-A-Car, Inc. v. Ford Motor Co.*, 526 P.2d 1136, 1139 (Alaska 1974); *Shade v. Co. & Anglo Alaska Service Corp.*, 901 P.2d 434, 436 (Alaska 1995).

The Alaska Supreme Court has reversed numerous cases granting summary judgment due to the existence of a genuine issue of material fact or the

failure of the moving party to show that it was entitled to judgment as a matter of law.⁵ The Federal Energy Regulatory Commission (FERC) has applied this same standard with similar results.⁶ This same standard was applied by the APUC in a previous oil pipeline case⁷ and is applied in this Docket.⁸ The Commission therefore requires Tesoro, as the moving party, to show that no genuine issue of material fact exists and that it is entitled to summary disposition as a matter of law.

The TAPS Carriers filed their direct case on October 8, 1998.⁹ Tesoro, for purposes of its motion, assumes all facts asserted in that case are true. Thus, there are no genuine issues of material fact to be resolved by the Commission. Tesoro is entitled to judgment as a matter of law if the TAPS Carriers have not established in those filings that their 1997 and 1998 rates are just and reasonable.

⁵See, e.g., *Alyeska Pipeline Service Co. v. H. C. Price Co.*, 694 P.2d 782 (Alaska 1985); *Totem Marine Tug & Barge, Inc. v. Alyeska Pipeline Service Co.*, 584 P.2d 15, 24-25 (Alaska 1978); *Alaska Laborers Training Fund v. P&R Enterprises, Inc.*, 583 P.2d 825 (Alaska 1978); *American Restaurant Group v. Clark*, 889 P.2d 595 (Alaska 1995); *Dayhoff v. Temsco Helicopters, Inc.*, 848 P.2d 1367 (Alaska 1993).

⁶See, e.g., 18 CFR § 385.287; *Columbia Gas Transmission Corp.* 42 FERC ¶ 61,022, at 61,132 (1988). See also *Coastal States Marketing*, 25 FERC ¶ 61,164 at 61,451 (1983); *Kansas Power & Light Co.*, 23 FERC ¶ 61,330 at 61,720 (1983).

⁷Order P-82-6(25)/P-92-5(6), dated May 25, 1993 (*Re Cook Inlet Pipe Line Company*, 13 APUC 266 (1993)).

⁸The Commission is aware that the TAPS Carriers rely on *State v. Meyers*, 906 P.2d 1365 (Alaska 1995) to assert that a summary disposition in the presence of a prima facie case is unlawful. See Carriers' Opposition, p. 19. Even assuming the TAPS Carriers' testimony presents a prima facie case as to whether the TSM is just and reasonable over the life of TAPS, that is not the issue in this Docket. The issue in this Docket is whether the 1997, 1998, 1999, and 2000 rates are just and reasonable.

⁹The TAPS Carriers' direct case included testimony from four witnesses and accompanying exhibits, comprising 27 spiral-bound volumes.

Just and Reasonable Standard

AS 42.06.370 requires that oil pipeline rates be "just and reasonable". The Commission has latitude in implementing AS 42.06.370. The APUC historically chose not to determine whether the TAPS Carriers' rates were just and reasonable because no protests¹⁰ had been filed asserting that rates were unjust and unreasonable.¹¹ The APUC has clearly preserved the right to determine if rates in any individual year are just and reasonable.¹²

¹⁰Petro Star, Inc. protested TSM rates as unjust and unreasonable in APUC Docket P-86-2 but settled with the TAPS Carriers for \$2.5 million. The APUC subsequently allowed the TAPS Carriers to use TSM to calculate intrastate rates in the absence of a protest but did not rule on whether TSM produces just and reasonable rates. Order P-86-2(41)/P-86-3(7)/P-90-1(12), dated October 29, 1993. *Re Amerada Hess Pipeline Corporation*, 13 APUC 448 (1993).

¹¹The Commission also has the authority under AS 42.06 to determine whether oil pipeline rates are just and reasonable on its own initiative, even in the absence of an economically impacted party.

¹²In its order on reconsideration (Order P-94-1(63)/P-95-1(43)/P-97-4(50)/P-97-6(29)/P-97-7(30), dated May 27, 1999) of Order Suspending 1999 TAPS Rates, the APUC stated that:

that order [Order Accepting Settlement] did not state that rates calculated in accordance with TSM would be accepted as final rates in the absence of a protest. Instead the Commission reserved the right to review TSM rates for justness and reasonableness. . . .

. . .

. . . The waiver of a revenue requirement filing indicates the Commission's willingness to waive the burdensome requirement of an annual showing of just and reasonable rates, but is not indicative of Commission intent to render itself unable to investigate TAPS rates in the absence of a protest. Such an interpretation of the Commission language in Order P-86-2(41) [Order Accepting Settlement] is irrational and would require the Commission to abdicate its statutory mandate to ensure that rates charged by the TAPS Carriers are just and reasonable. . . .

(continued)

Now that Tesoro, an economically affected party, has protested TAPS rates, the Commission must address what is required to determine if a rate is just and reasonable under AS 42.06. The Commission recognizes that "in arriving at a just and reasonable rate no single method need be followed." *Wisconsin v. Federal Power Commission*, 373 U.S. 294 (1963). With respect to FERC, the United States Supreme Court has found that FERC is not required "to adhere rigidly to a cost-based determination of rates, much less to one that bases each producer's rate on his own costs." *FERC v. Pennzoil Producing Co.*, 439 U.S. 508 (1979) quoting *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. 283 (1974).

Nonetheless, the Commission recognizes that the power to prescribe rates is accompanied by statutory standards to which it must conform. AS 42.06. "Under the statutory standard of just and reasonable it is the result reached not the method employed which is controlling. . . . It is not the theory but the impact of the rate order that counts." *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Therefore, in this Docket, despite the inordinate amount of briefing and expert testimony on TSM, the Commission is not determining whether TSM is a just and reasonable methodology over the life of the pipeline. Rather, the

. . .
. . . The Commission believes that statute [AS 42.06.400(a)] clearly establishes its authority to institute an investigation into the TAPS rates regardless of whether a protest has been filed.

Commission must address whether the resulting rates in 1997 and 1998 are just and reasonable.¹³

To make this determination the Commission must look to the basic principles developed by the judiciary to insure that rate-making agencies satisfy their obligation to approve only rates that are just and reasonable. Decades of judicial review of agency determinations of "just and reasonable" reveal a basic principle: an agency may issue, and courts are without authority to invalidate, rates orders that fall within a "zone of reasonableness," i.e., where rates are neither "less than compensatory" nor "excessive." See, e.g., *FERC v. Pennzoil Producing Co.*, 439 U.S. 508 at 517; *Re Area Rate Proceeding for Permian Basin*, 390 U.S. at 797 (1968). The "zone of reasonableness is delineated by striking a fair balance between the financial interests of the regulated company and the relevant public interests, both existing and foreseeable." *Area Rate Proceeding for Permian Basin*, 390 U.S. at 792; see *FERC v. Pennzoil Producing Co.*, 439 U.S. at 519; *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631 (1973).

The most useful and reliable starting point for rate regulation is an inquiry into costs. See, e.g., *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. at 305, 316; *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. at 602, 603. Non-cost factors may legitimize a departure from a rigid cost-based approach. See,

¹³The justness and reasonableness of the 1999 and 2000 rates, which are also the subject of this proceeding, must be addressed at a later time because the TAPS Carriers have thus far had no opportunity to file a direct case to support those rates.

e.g., *Pennzoil Products*, 439 U.S. at 518; *Mobil Oil*, 417 U.S. at 308. However, as the D.C. Court of Appeals in *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 59 PUR4th 1 (D.C. Cir. 1984) explained, "the mere invocation of a non-cost factor . . . does not alleviate a reviewing court of its duty to assure itself that the commission has given reasoned consideration to each of the pertinent factors." "Each deviation from cost based pricing [must be] found not to be unreasonable and to be consistent with the commission's statutory responsibility." *Mobil Oil*, 417 U.S. at 308; see *Pennzoil Products*, 439 U.S. at 518. Thus, with respect to non-cost based factors, when the Commission approves rates containing such factors, a reasonable explanation of each non-cost factor must be made to justify the resulting rate for the specific years in question. See *Farmer's Union*, 734 F.2d 1486, at 1502-03, 1530.

To be found just and reasonable, the rates under consideration in this Docket must fall within the "zone of reasonableness." That zone is found by striking a balance between the financial interest of the regulated company and the relevant public interests, both existing and foreseeable. *Area Rate Proceeding for the Permian Basin*, 390 U.S. at 792. The rates must afford the owners of the pipeline a fair opportunity to earn a return commensurate with the risk of their capital investment, see, e.g., *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944), under tariffs that are fair and nondiscriminatory toward shippers and other members of the relevant public. To the extent that non-cost based factors are identified by the TAPS Carriers such factors can be included in a rate only if, after a reasoned explanation, their inclusion nonetheless results in a rate that falls within the zone of reasonableness.

Applying the Evidence in this Proceeding to the
Test for Just and Reasonable TAPS Rates

The evidence presented by the TAPS Carriers and the State in this Docket is not directed at determining whether the rates for 1997 and 1998 are just and reasonable. A great deal of evidence and briefing is directed at whether TSM is a just and reasonable methodology over the life of the pipeline. Such evidence does not prove that the resulting rates for the years 1997 and 1998 are just and reasonable.

In defending TSM, the Carriers and the State did not address whether or how the resulting rates could be just and reasonable from the perspective of a shipper or the public in any particular year. TSM may, from the perspective of TAPS Carriers and the State, be a just and reasonable methodology for establishing rates over the life of the pipeline. That, however, is not the issue in this proceeding.

Instead, the Commission must address whether evidence has been presented that supports a finding that the 1997 and 1998 rates are just and reasonable. Looking exclusively to the evidence presented on this issue, the Commission finds that the Carriers have failed to provide material evidence that justifies the 1997 and 1998 rates as just and reasonable. Following is a review of the three areas of evidence presented by the Carriers in an attempt to defeat Tesoro's motion for summary disposition.

First, as the Commission has noted earlier, "the most useful and reliable starting point for rate regulation is an inquiry into costs." *Supra* at p. 9, quoting *Mobil Oil*, 417 U.S. at 305, 316. The Carriers have provided no evidence of actual depreciation costs. They provided testimony showing that the 1997 and 1998 rates

calculated under two different methodologies, Depreciated Original Cost (DOC) and Trended Original Cost (TOC), are higher than the 1997 and 1998 TSM rates. The rate base numbers used for those calculations, however, bear no relation to the rate base that has been used by the Carriers to calculate TAPS rates for the last fifteen years. Instead, they are based on hypothetical rate bases constructed by the TAPS Carriers. Therefore, the Carriers have failed to present the Commission with a factual basis for determining whether the 1997 and 1998 rates are just and reasonable.

Second, the Carriers' argument that TSM is a reasonable method for determining rates raises serious questions of inequity from the financial perspective of individual shippers and the public. If the Commission makes all reasonable inferences in favor of the Carriers and, for purposes of argument, assumes that the Carriers have shown that TSM is just and reasonable over the life of the pipeline, that proof does not ensure that individual shippers and members of the public are treated fairly in any given year. It only ensures that the Carriers receive a just and reasonable return over the life of their investment. For example, if the depreciation profile of a methodology is extremely accelerated, the accelerated depreciation results in rates that are high in early years and low in later years thereby skewing when and which shippers may ship and the prices the public may pay in any given year. From the carriers' financial perspective, however, the rates are just and reasonable over the life of the pipeline. The Commission must determine that the rates are fair and nondiscriminatory with respect to the shippers, the public and the Carriers in each year.

Third, inequalities also occur if a pipeline carrier is allowed to base its rates on non-cost factors that do not have a reasoned explanation. For example, in this proceeding, the Allowance per Barrel (APB) has been identified as a non-cost-based factor used to calculate TSM rates. The Carriers have given only one explanation for its inclusion. "While APB may not appear cost based when viewed in isolation, it is but one component of an overall settlement agreement designed to provide the TAPS Carriers with the opportunity, over the life of the settlement to recover their costs (including a reasonable return on investment)." Carriers' Opposition, p. 18. The Carriers have failed to provide evidence that the inclusion of such a non-cost-based factor is fair and nondiscriminatory from the financial perspective of the shippers and public for 1997 and 1998. Their failure to do so makes it impossible for the Commission to determine whether shippers and the public are being treated unfairly in 1997 and 1998 at the whim of a scheme that ensures that Carriers are treated justly and reasonably over the life of the pipeline.

Conclusion

The Commission has identified three problem areas: DOC and TOC methodologies, TSM methodology, and inclusion of non-cost based factors. With respect to the DOC and TOC calculations for the years in question, the Carriers have failed to provide any factual evidence on which the Commission can rely to determine whether the 1997 and 1998 rates are just and reasonable.

Where the Carriers used actual numbers, they relied on TSM as a methodology for showing only that the rates at issue are just and reasonable over the

life of the pipeline. They failed to provide any evidence demonstrating that the rates are also fair and nondiscriminatory toward shippers and the public in the years that are the focus of this case.

Most troublesome, however, is that the Carriers have failed to provide a reasoned and complete explanation of why non-cost-based factors are included in TAPS rates. Under AS 42.06 the Commission can find the rates at issue just and reasonable only if they strike a fair balance between the existing and foreseeable financial interests of the Carriers, the shippers, and the public. Non-cost based factors may not be included in rates before the TAPS Carriers provide the Commission with evidence to support a reasoned explanation that including non-cost factors will strike such a balance.

Although TSM may coincidentally arrive at a just and reasonable rate in a particular year, it fails to provide, as presented so far in this proceeding, a mechanism for determining whether the rates at issue fall within the zone of reasonableness. The Carriers have failed as a matter of law to show that the rates are neither less than compensatory nor excessive and that they strike a fair balance between the financial interests of the Carriers, the shippers, and public. The evidence presented by the Carriers simply does not address whether shippers and the public are being treated fairly from year to year.¹⁴ The TAPS Carriers have therefore failed to present evidence

¹⁴Such a question is of particular importance to the Commission. No competition exists for alternative shipping routes from the North Slope; the nature, mix,
(continued)

sufficient to defeat Tesoro's motion for summary disposition. As a matter of law, Tesoro's motion for summary disposition is granted.¹⁵

Docket P-97-4, however, remains open. Just and reasonable rates for 1997, 1998, 1999, and 2000 must be established. Although the Commission in this Order finds that the TAPS Carriers have failed to justify their 1997 and 1998 rates, it does not make an explicit finding that those rates are not just and reasonable. The TAPS Carriers now have an opportunity to file a case proving that their filed 1997, 1998, 1999, and 2000 rates¹⁶ are just and reasonable, or to file a case justifying lower rates and acknowledging refunds due for the subject years. The Commission establishes the following procedural schedule for adjudicating 1997, 1998, 1999, and 2000 rates:

July 12, 2000	TAPS Carriers file case-in-chief
July 26, 2000	File testimony and exhibits in support of TAPS Carriers' case-in-chief

and ownership of production on the North Slope is changing; and most of the Carriers and shippers are currently affiliated.

¹⁵Tesoro's calculations do not form the basis for the Commission's granting of Tesoro's motion. The motion is granted solely because the TAPS Carriers failed to provide evidence that the 1997 and 1998 are just and reasonable.

¹⁶At the time its previous case was filed, the 1999 and 2000 rates had not yet been filed. The filing required by the Order should include justification for rates for all four years.

September 27, 2000	Complete discovery concerning TAPS Carriers' and State's initial filings
October 11, 2000	File testimony and exhibits in opposition to TAPS Carriers' case-in-chief and filings in support of case-in-chief
December 6, 2000	Complete discovery concerning testimony and exhibits filed in opposition to TAPS Carriers' case-in-chief
December 20, 2000	TAPS Carriers file rebuttal testimony and exhibits
February 13, 2001	Complete discovery concerning rebuttal testimony and exhibits
February 26, 2001	File prehearing briefs
March 6, 2001	Hearing begins

ORDER

THE COMMISSION FURTHER ORDERS:

1. The First Motion for Summary Disposition filed by Tesoro Alaska Petroleum Company on March 15, 1999, is granted.
2. A public hearing¹⁷ will commence on March 6, 2001, at 8:30 a.m. in the Commission's hearing room located at 1016 West Sixth Avenue, Suite 305,

¹⁷If you are a person with a disability who may need a special accommodation, auxiliary aid, or service or alternative communication format in order to participate in this public hearing, please contact Barbara J. Miller at 1-907-276-6222 or TTY 1-907-276-4533 at least 2 weeks before the public hearing to make the necessary arrangements.

Anchorage, Alaska. The hearing will be conducted in accordance with the Commission's regulations and the direction of the Administrative Law Judge.

3. By 4 p.m., July 12, 2000, Amerada Hess Pipeline Corporation, ARCO Transportation Alaska, Inc., BP Pipelines (Alaska) Inc., Exxon Pipeline Company, Mobil Alaska Pipeline Company, Phillips Alaska Pipeline Corporation, and Unocal Pipeline Company shall jointly or separately file their case-in-chief or cases-in-chief, including testimony and exhibits.

4. By 4 p.m., July 26, 2000, any party that wishes to file testimony and exhibits in support of the TAPS Carriers' case-in-chief filing must do so.

5. By September 27, 2000, discovery concerning the TAPS Carriers' case-in-chief and the testimony filed in support of that case-in-chief shall be completed.

6. By 4 p.m., October 11, 2000, any party filing in opposition to the TAPS Carriers' case-in-chief shall file its prepared testimony and exhibits.

7. By December 6, 2000, discovery concerning the testimony and exhibits of parties filing in opposition to the TAPS Carriers' case-in-chief shall be completed.

8. By 4 p.m., December 20, 2000, any prefiled testimony and exhibits that the TAPS Carriers may wish to file in rebuttal to prefiled testimony and exhibits of opposing parties shall be filed.

9. By February 13, 2001, discovery concerning rebuttal testimony and exhibits shall be completed.

10. By 4 p.m., February 26, 2001, each party wishing to file a prehearing brief (which may include a statement of the issues to be addressed at hearing) must do so.

11. All parties must serve all work papers generated in support of their prepared testimony and exhibits on all other parties at the time that the testimony and exhibits are filed with the Commission.

BY DIRECTION OF THE COMMISSION
(Commissioners Bernie Smith and Will Abbott, not participating.)

(S E A L)

House Special Committee on Oil and Gas
April 13th, 2000
Hearing on:
Trans-Alaska Pipeline System (TAPS)
Tariffs as Impacted by IRS Treatment of Dismantling, Removal & Restoration
(DR&R) Funds

Testifying:

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*In the packets —
copies of — Mr. Fineberg's testimony,
and supporting exhibits, copies of the
briefs filed by the Dept. of Law with the
RCA, and a copy of the Order by RCA
regarding the claim by Tesoro. •*

**Federal Income Tax Payments on the Dismantling Element of the
Trans-Alaska Pipeline System (TAPS) Tariff**

**Testimony of Richard A. Fineberg before the
Oil & Gas Committee
Alaska State House of Representatives**

April 13, 2000

Introduction

Thank you, Mr. Chairman, for your interest in federal income tax payments on the dismantling element of the Trans-Alaska Pipeline System (TAPS) tariff. While DR&R collections are minimal today, the owners of TAPS have, by their own calculations, collected more than \$760 million from shippers for income taxes, most of which they never actually paid.¹ This sleight-of-hand has probably cost the State of Alaska more than \$160 million in revenue.² (These are nominal-dollar figures; in inflation-adjusted, year-2000 dollars, the figures would be significantly higher.) These are only estimates because we still don't yet know the exact dimensions of this long-running scam. From a policy standpoint, I am troubled by the fact that the Administration only recently discovered the problem. From the record, it appears that an alert administration should have identified and remedied this problem long ago.

It might be useful to come at this issue by considering two background questions. First: Why are pipeline tariffs significant to North Slope oil policy? Next: How do pipeline dismantling costs fit into the tariff the owners of TAPS collect for shipping oil through the pipeline? In the third segment, I'll describe what we know about this problem. To conclude I'll address, as best I can, these questions: How did it come to pass that for two decades the TAPS owners apparently collected revenues from TAPS shippers for federal income taxes they didn't have to pay? Why is this strange story only now

¹ "State of Alaska's Response to Commission's Request for Joint A Stipulation of Facts," Regulatory Commission of Alaska, Docket No. P-97-7, Oct. 25, 1999, pp. 3-5; "TAPS Carriers' Revised Statement of Facts," Docket No. P-97-7, Nov. 12, 1999, pp. 2-4. (Attached here as Exhibit A.)

² Estimate, based on the 25% ratio, applied only to fed income tax portion (see Part III., below).

coming to light? We have a lot of ground to cover, but if you're not with me at the end, then there's no point in taking the trip. Therefore, I hope you will stop me if you have questions.

I. Why Should We Care about Pipeline Tariffs?

North Slope oil is handicapped in world competition by its relatively high transportation costs. The largest of these is the tariff or shipping charge for TAPS, which constitutes about 40 per cent of total production and delivery costs. TAPS also provides one-quarter to one-third of industry profits from Alaska operations — and an even higher percentage at low prices.³ From a policy standpoint, the State should be concerned about the level of TAPS tariffs for three fundamental reasons:

- First, the more it costs to deliver ANS to the refinery, the less competitive that oil will be in the world market.
- Second, three companies that presently own the rights to more than 90% of North Slope production also own more than 90% of TAPS. These three companies therefore stand to benefit from excessive TAPS tariffs, to the detriment of the non-owner shippers who must pay those charges out of pocket. Put otherwise: TAPS owners have a competitive advantage over non-owner shippers; that edge that would be increased by excessive tariff charges. Exhibit B — a simplified table comparing company profits of a non-owner shipper to those of TAPS owner — demonstrates this point.
- Finally, as indicated at the outset, excessive TAPS tariffs deprive the State of Alaska of revenue. Moreover, the benefit of any excess tariffs that the TAPS owners can slide through the regulatory system accrue to themselves — again to the detriment of real or potential competitors. As a general rule of thumb, an increase of \$1.00 per barrel in the value of a barrel of oil at the refinery gate increases State revenues by about a \$0.25. The industry takes about \$0.50 of the total gain, with the Federal government picking up the remainder. In Exhibit C, the hypothetical TAPS tariff is increased by \$1.00 per barrel to demonstrate that the industry — and the

³ See: Richard A. Fineberg, *How Much Is Enough? Estimated Industry profits from Alaska North Slope Production and Associated Pipeline Operations, 1993 - 1998* (Oilwatch Alaska, 1998).

TAPS owners in particular — are the prime beneficiaries of increases in oil prices or TAPS tariffs.

TAPS tariffs are regulated by the Federal Energy Regulatory Commission (FERC) and the Regulatory Commission of Alaska (RCA).⁴ Industry spokesmen argue that the regulatory regime safeguards state revenue and North Slope competition by ensuring that pipeline tariffs are not excessive.⁵ Some (myself included) would disagree with that notion. I submit that if you pierce the complicated veil of tariff mechanics, you will find that the TAPS tariff has served industry purposes and that tariff regulation, while serving as a full employment act for lawyers, functions very much like a rubber stamp.

The framework for determining TAPS tariffs is known as the TAPS Settlement Agreement.⁶ The State entered into the controversial 1985 agreement with the TAPS owners to terminate a decade-long legal battle that the Alaska Department of Law described as "the largest utility rate case ever presented."⁷ The negotiated agreement established the TAPS Settlement Methodology (TSM). The State has typically joined the industry in defending the TAPS Settlement, rejecting the suggestion that regulation of TAPS failed to secure the state's interests in this important area.⁸ But last August, in the long-awaited announcement of the State's goals on the ARCO-BP merger in Anchorage, the Governor declared that he would seek reduced tariffs on TAPS because those charges were excessive and

⁴ FERC operates under the Interstate Commerce Act, 49 USCS 1, *et seq.* The State regulates the intra-state tariffs under Alaska Pipeline Act, which is codified at AS 42.06 *et seq.*

⁵ See, for example, Cambridge Energy Research Associates, *Operations of the Trans Alaska Pipeline System: Impact of the Merger between BP Amoco and ARCO* ("White Paper" prepared for BP Exploration), September 1999.

⁶ *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* (Federal Energy Regulatory Commission Docket OR 78-1), June 28, 1985.

⁷ 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.

⁸ See, for example, Bruce M. Botelho, "Re: *The Big Squeeze*," Nov. 7, 1997 (letter to Jim Sykes, Executive Director, Oilwatch Alaska [14 pages, with attachments]).

constituted a barrier to competition.⁹ During the Special Session on subsistence in Juneau one month later, some of you heard the very same thing from Commissioner of Natural Resources John Shively, who echoed this view during a lengthy hearing on the ARCO-BP merger.¹⁰ The Administration's new position constituted a sea-change in policy. Unfortunately, however, when the Charter for Development was finally revealed ten weeks later, the Governor had tacked; the Charter did not provide lower TAPS tariffs and it remains to be seen whether the ship of state has actually changed course.¹¹

II. Pipeline Dismantling Costs

Under the TSM, the maximum allowable tariff the TAPS owners can levy is, in essence, the sum of seven components:

- operating expenses — the cash Alyeska Pipeline Service Co. draws from the TAPS owners for TAPS operations and maintenance;
- capital costs — recovery of original investment;
- state and local property taxes;
- state and federal income tax;
- after-tax margin — profit;
- recovery of deferred return — an allowance representing deferred income the owners collect in recognition of earlier capital costs (a conventional allowance for funds used during construction and deferred payments representing the inflation component of return on rate base); and
- an allowance for the future costs of dismantling and removing facilities and restoration of the TAPS corridor (DR&R).¹²

⁹ The Governor noted that "even industry users acknowledge TAPS to be a major profit center, with tariffs substantially in excess of costs of operation." According to the Governor, "the state would gain revenue from this (reduced tariffs), but the chief purpose of reducing tariffs would be to guarantee a fair price that would not serve as an obstacle to competition." See: "Governor Tony Knowles remarks — Anchorage Chamber of Commerce on BP-ARCO Acquisition, 8/23/99, Egan Center," p. 5.

¹⁰ The Commissioner's remarks were made in hearings before the Legislature's Special Joint Committee on Mergers, Juneau, Sept. 25, 1999.

¹¹ Instead, Governor retroactively added "or divestiture" to his public list of merger goals. See: "Governor's Conditions On Competition," Slide 5 of "Powerpoint" presentation, November 1999 (available on-line at: www.gov.state.ak.us/bparco.html).

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* (Federal Energy Regulatory Commission Docket OR 78-1), June 28, 1985. TSM includes property taxes with operating expenses and therefore identifies only six tariff elements. See: State of Alaska and U.S. Department of Justice, *Explanatory Statement of the State of Alaska and the*

The creators of TSM described it as a novel methodology; I think it's fair to say that DR&R is one of its most unusual aspects. The need for dismantling funds was established by the 1974 State right-of-way and Federal lease agreements, which required the TAPS owners to dismantle facilities and restore the right-of-way (DR&R) at the end of pipeline operations.¹³ The inclusion of this requirement in the pipeline authorization arrangements reflected the growing public concern with environmental issues that characterized the 1970's. In the TAPS settlement a decade later, TSM stipulated specific amounts for DR&R during each year of the 34-year period covered by the settlement, from 1977 through 2011. Those annual payments were concocted on a dense spreadsheet that only an accountant could love. A replica is attached as Exhibit D. The actual collection amounts resulting from the various formulae in the spreadsheet appear in Column (L) of that exhibit. Note that many of the key assumptions that produced the numbers in Column (L) — for example, the date for the eventual dismantling of TAPS — were not part of the settlement itself. Nor were key provisions of financial and accounting arrangements.¹⁴

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.

¹³ 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 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.])

¹⁴ Section II-4 of the 1985 agreement established the basis for funding this tariff element in this short statement: "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." The exhibit consists of a single columns of numbers listing the amount the TAPS owners may collect for DR&R during each the life of the settlement, starting with \$110.377 million in 1984 and ending with \$0.796 million in