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OVERVIEW OF PRESENT MAJOR OIL LITIGATION

A. Introduction. The State is presently in the middle of one of the largest litigation efforts in U.S. history. The amounts at issue in the State's oil and gas litigation total at least 15 to 20 billion dollars in present day dollars. The cases range from a title dispute with the federal government over valuable oil and gas lands in the Beaufort Sea (U.S. v. Alaska), wide-ranging disputes with a number of companies over the valuation of Alaska North Slope (ANS) crude oil (State v. Amerada Hess, State v. Alaska Oil, MDL-150), through litigation over the State's novel corporate income tax scheme of 1980-81 (Arco v. State), to the largest utility rate case ever presented (The Trans Alaska Pipeline Rate Case). These cases are characterized by their complexity and the enormous effort that is required to litigate them successfully. In some of these cases literally millions of documents have had to be examined. Hundreds of expert witnesses have given testimony and thousands of hours of hearings have been conducted. Similar activity is expected over the next few years.

The Oil and Gas Pricing Cases and Trans Alaska Pipeline Rate Case, described more specifically below, revolve primarily around a single concern: What is the value of Alaska North Slope oil at the point it enters the Trans Alaska Pipeline? The State's oil and gas revenues are primarily derived from the value of ANS oil at that point. It is the value at that point which

determines the amount taxed for the State oil and gas production tax. It is also the amount that the State is owed for its royalty share of ANS production, and is also the price term at which the State sells its royalty oil to third parties.

That value, in turn, is determined by the price that the oil commands in the distant markets of the West Coast of the United States and the Gulf Coast, minus the cost of moving the oil through the Trans Alaska Pipeline and by tanker to the various ports and refineries where it is sold. The higher the transportation costs, the lower the wellhead value and, consequently oil and gas revenues. In addition, the marketing of Prudhoe Bay oil in the lower 48 is a complex matter -- not only is a large portion of the oil sold in internal transfers from one company division to another, but also the oil that is sold to third parties is often sold in exchanges with other considerations than simply price attached. As a result, the value of the oil at those distant markets is not a clearcut issue, and the State contends that the amounts reported by the producers for the value of the oil when it reaches its ultimate destinations are too low by a significant amount.

Much of the State's oil and gas litigation revolves around the determinations of the level of transportation costs

and the price received for the oil at its ultimate destination. For every dollar per barrel change in those elements, the State will receive approximately 25 to 30 cents of that amount in increased royalty and production tax. At presently projected production rates from State lands through the year 2010, this involves approximately 3.75 to 4.5 billion dollars in present day dollars for every dollar per barrel change as a result of this litigation.

B. Oil and Gas Pricing Cases -- State v. Amerada Hess (North Slope Royalty Case), State v. Alaska Oil, MDL-150 (California Anti-trust Case). The amounts at issue in these cases collectively for both past and future royalties are likely upwards of two billion dollars in present day dollars. This group of cases revolves around the twin questions of the value of the oil at its ultimate point of sale in the lower 48, and the cost of moving the oil by tanker from Valdez to the points of sale. (The Trans Alaska Pipeline charge is a subject of a separate lawsuit to be explained later.) Three cases presently involve similar factual issues concerning the value of Prudhoe Bay oil. The main case is the North Slope royalty case, State v. Amerada Hess, et al.. This case involves the valuation of the State's royalty share of oil from Prudhoe Bay. The two primary issues are the proper value to be attributed to North Slope crude

oil when it reaches the lower 48, and second, the proper deductions to be made for tanker transportation in arriving at a value of the oil as it enters the Trans Alaska Pipeline System. A previous part of the case, involving the amount that could properly be charged against the State's royalty for field costs, was settled in 1980.

In addition to the North Slope Royalty Case, there are two other lawsuits which involve similar issues. One is the Alaska Oil price dispute, which involves the attempt of the State to recover approximately 62 million dollars withheld by the Alaska Oil Company for royalty oil sold to that company during the period July 1980 through February 1982. The contract with Alaska Oil required that it pay the "in-value" price, which was to be determined under the North Slope Royalty Case. Alaska Oil disputed the amounts billed by the State from the producer royalty reports, contending that the producers were reporting prices which were too high. The State disagreed, and attempted to quickly resolve the matter by going straight to bankruptcy court. The bankruptcy court ruled that bankruptcy was not appropriate at that time and the case is now before the State superior court on the issue of the amount of the debt. That case has been stayed pending the Charter bankruptcy in Florida. Since the amount of the debt is determined by the "in-value" price, the

resolution of this case will involve many of the same issues and facts as the North Slope royalty and production tax cases.

In another case the State was successful in asking the federal district court in the central district of California (at Los Angeles) to allow it to gain access to confidential information discovered in an anti-trust case brought by the State of California and the City of Long Beach against California oil companies. The case is entitled MDL-150. This case involves an alleged conspiracy to undervalue California crude oil. Since ANS crude oil competes with California crude oil for markets on the West Coast, the State may have a corresponding claim for damages depending upon the particular facts of that litigation.

In essence, these cases will require the State to make a detailed factual review of all West Coast and Gulf Coast oil marketing transactions for a seven year period, and will have to track the disposition of billions of barrels of ANS crude oil. Because of the similar factual circumstances, these cases will have to be closely coordinated among themselves and with portions of the Trans Alaska Pipeline Rate Case which involve similar issues. The massive discovery, document evaluation, and expert preparation will have to result in a consistent position in all of the cases.

FY 86-87 will be the peak years of activity in these cases. These cases are presently in a state of preliminary discovery, with the State and the companies both battling on the production of documents and confidentiality to be attached to those documents. By the beginning of FY 85 experts (whose testimony is essential) have been selected, the preliminary battles over discovery are over, and large amounts of documents have begun to arrive (expected to total two to three million documents by the end of discovery). Also, a system to code, index, and computerize these documents is being put in place. In FY 85, then, the State began actual work on these cases; documents still need to be analyzed, depositions taken, and experts prepared.

State v. Phillips and State v. Marathon were cases involving the value of the State's royalty gas from the North Cook Inlet and Kenai fields. The Phillips case was settled last year, resulting in a payment of about $30 million to the State for past royalties, and an increase of $12 million per year in future royalties.

C. Trans Alaska Pipeline Rate Case. The case which has received the most intense litigation effort at this point is the Trans Alaska Pipeline Rate Case. The amounts at issue

between the best case and the worst case outcomes, over the life of the field, are approximately 7 to 10 billion dollars in present day dollars.

This case involves the appropriate tariff to be charged for transporting oil through the Trans Alaska Pipeline System (TAPS). The case is in two parts. The first part is the question of the proper methodology, or formula, to be used in calculating the tariff. The second part involves the actual numbers, including the cost of construction, to be put into the formula. The case has been litigated since 1977, and prompt resolution is not expected.

Phase I of the case is now on "hold" after a number of delays. The F.E.R.C. has informally indicated that it does not want to resolve the TAPS case.

The trial of the second part of the case, primarily involving the prudent cost of constructing the Trans Alaska Pipeline, is now over and is being briefed before an administrative law judge.

The State is now attempting to settle this dispute, and has reached an agreement with Arco. The other companies have not yet signed on.

D. Arco v. State (The Oil and Gas Corporate Income Tax Case). This case involves a question of the constitutionality of Alaska's previous oil and gas corporate income tax. That tax was based on a concept of "separate accounting," which attempted to isolate those profits made by oil and gas operations in Alaska. Other states often use a concept called "formula apportionment," which divides total corporate profits by the percentage of certain factors (usually payroll, sales, and property) in each particular state. The companies are basically charging that our unique formula violated the Commerce Clause by resulting in double taxation. The amount at issue is approximately two billion dollars, which the State has collected and would have to refund if the State lost the case. The State won the case at the superior court level on summary judgment (without trial), and the case is presently on appeal to the Alaska Supreme Court. The Alaska Supreme Court is likely to rule in early FY 86, and can either affirm our victory, reverse and rule that our taxation scheme was unconstitutional, or it could remand the case back to superior court for a full trial on a number of factual issues.

E. U.S. v. Alaska. U.S. v. Alaska is a case before the United States Supreme Curt involving title to lands in the Beaufort Sea. At the 1979 joint state-federal Beaufort Sea Oil and Gas Lease Sale, the disputed lands at issue in this lawsuit drew $536,000,000 in bonus bids alone. Those lands have some of the highest potential for oil and gas development in the State, and if we are successful, the State will gain billions of dollars in extra royalties and taxes. Over $980 million is presently in escrow. Moreover, the principles established in this case would govern such disputes in virtually all areas of Alaska's coast. Given the industry's current interest in offshore oil and gas leasing, the possible benefit to the State from 1979 lease sale if a favorable decision is reached could be multiplied many times over as those principles are extended to other areas of Alaska's coast. The case is presently being heard before a special master appointed by the United States Supreme Court.