

State of Alaska FY2002 Governor's Operating Budget

Department of Law
Oil and Gas Litigation and Legal Services
Budget Request Unit

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BRU Mission

Mission statement appears at the department summary level.

BRU Services Provided

Most of the state's operating revenues are derived from oil and gas corporate income taxes, production taxes, and royalties on Alaska North Slope ("ANS") crude oil. The value of that crude for production tax and royalty purposes is largely determined by the price that ANS commands in its destination markets, less the costs of transporting it to those markets. The transportation costs, in turn, consist primarily of the tariffs charged by the Trans-Alaska Pipeline System ("TAPS") and the producers' tanker costs. Accurately determining ANS destination values, allowable transportation costs, and corporate income ensures the integrity of the state's fiscal system.

The Oil and Gas Litigation and Legal Services appropriation funds legal services related to these and other oil and gas development issues. These services include tariff disputes with the owners of TAPS and its feeder pipelines and the assessment and collection of unpaid royalties and taxes from oil and gas producers. Legal services related to lease sales, drafting and interpreting oil and gas statutes and regulations, pipeline right-of-way issues, and oil and gas conservation are also funded by this appropriation, as are the contracts with outside counsel and expert consultants on large or complex oil and gas cases.

Because legal services related to oil and gas development have a significant effect on that development and the amount of state revenue derived from it, these services are funded separately within the Department of Law's operating budget. This enhances the ability of the governor and the legislature to ensure that an appropriate level of funding is made for these services.

PIPELINE-RELATED CASES

The state has expended substantial resources to monitor compliance with the 1985 TAPS settlement. The department performs this function by reviewing and challenging tariff filings by the owners of the pipelines operating in the state. This vigilance can earn the state millions of dollars annually. As production of oil continues to decline in Alaska, this monitoring is becoming more and more important because transportation costs through TAPS are a major component of total transportation costs to destination markets.

A TAPS shipper has protested intrastate tariffs before the Regulatory Commission of Alaska. Intrastate and interstate tariffs are set according to the TAPS Settlement Methodologies (TSM), agreed to in 1985. The state has achieved significant benefits from the TSM, both interstate and intrastate, and is contractually obligated to defend the methodologies. While the state regularly monitors tariffs to ensure that the methodologies are correctly followed, the protest raised in this case challenges some of the bases of the TSM methodology. As a major rate case, the matter requires significant assistance from contract counsel and experts. The state has protested tariffs on the Cook Inlet Pipeline, and the new Alpine pipeline. These rate cases also require experts and assistance from contract counsel.

The department also will finance an annual audit of Alyeska Pipeline Services Company and the major owner companies to determine if certain operating and capital costs are properly included in the TAPS tariff. Information revealed during the audit forms the basis for future tariff protests. Litigation may result if Alyeska and the owners fail to respond adequately to the state's requests for information.

Another case that has not been resolved involves a dispute among TAPS over the effects on tariffs caused by quality bank adjustments, which are adjustments made to compensate for the different qualities of crude oil and refinery return streams flowing through TAPS. Some of the parties (including the state) have agreed to a settlement but two other parties are opposing the settlement.

Renewal of the TAPS right-of-way lease, which expires in 2004, is a major project that requires significant resources. Alyeska, the federal government, and the state are currently engaged in discussions involving how compliance with existing lease terms will be measured and how a new lease will be negotiated.

The department will also provide legal assistance to support the Alaska North Slope natural gas development project. Both in-house and outside counsel will be used in this endeavor.

TAX CASES

This department is pursuing millions of dollars in past-due taxes and interest that are owed by oil and gas producers to the state. In some cases, tens of thousands of documents have to be examined and numerous potential witnesses have to be interviewed or deposed in order to prepare for hearing. These hearings can last for months. At this time, one tax case appears headed for a hearing. Nevertheless, the department will be expending far less money on these cases in FY2002 than it has in the not-too-distant past, as a consequence of its successful efforts to resolve most of the state's major disputes with its oil and gas producers.

The department also anticipates that it may litigate several complex property tax cases involving the Trans-Alaska Pipeline and other oil and gas properties during FY2002. These cases will require the advice and testimony of expert witnesses, and may require the assistance of contract counsel.

ROYALTY CASES

Royalty disputes regularly arise between the oil and gas producers and the state. Although the department handles most of these disputes in-house, assistance from outside counsel and experts is sometimes necessary. For example, several of the producers have reopened negotiations over the previously settled Alaska North Slope royalty disputes based on marketplace changes. The department will require assistance from some of the outside attorneys and experts originally involved in the royalty dispute.

OIL AND GAS MERGER AND PRODUCT PRICING INVESTIGATIONS

The department is currently investigating the proposed merger of Chevron and Texaco and the level of petroleum product prices in the state. Both of these investigations will involve the review of hundreds of boxes of documents, and will rely heavily on the use of outside expert consultants.

BRU Goals and Strategies

To maximize the state's revenues by enforcing antitrust laws against oil and gas companies.

To maximize the state's revenues by enforcing the state's oil and gas royalty and taxation statutes and regulations.

To maximize the state's revenues through monitoring expenses that reduce oil and gas valuation.

To protect valuable state lands and resources against title and lease challenges.

To maximize the state's revenues through development of natural gas resources.

Key BRU Issues for FY2001 – 2002

Appropriations for Oil and Gas Litigation have steadily declined from \$32.9 million in FY 1994, to \$11.9 million in FY 1997, and to \$4.9 million in FY 2001. The department is requesting level funding in FY 2002.

The amount requested for this BRU over the last few years reflects a sharp reduction in the use of outside counsel and a major shift of responsibility for major oil and gas litigation from outside counsel to staff attorneys. The department attorneys are expected to litigate most tax cases with little or no assistance from outside counsel and

consultants. However, the department will continue to require substantial amounts to cover the cost of experts and document handling for these cases.

Although the amounts requested to pursue the state's oil and gas litigation efforts are large, they will return substantial revenues to the state treasury. Expenditures by producers in the past have far exceeded the state's. For this reason, the section is careful to ensure that the state's litigation resources are managed to their best advantage, particularly with respect to containing outside counsel costs by close contract supervision and shifting substantial responsibility to staff attorneys.

Major BRU Accomplishments for FY2000

- Protected the state's revenue, resource development, environmental, and societal interests in antitrust matters involving oil and gas companies in Alaska.
- Defended state's tariff settlement agreements during the period of the agreements to ensure that the state receives the benefits of those agreements.
- Pursued legal remedies that will determine the cost of processing the state's royalty share of natural gas liquids.
- Pursued oil and gas tax assessments made by state tax auditors in both the oil and gas audit and income and excise tax divisions.
- Pursued the state's interests in net profit share oil leases.
- Promoted further oil and gas development in Alaska by assisting resource agencies in drafting regulations, defending lease sales, and accomplishing other tasks in aid of development.
- Successfully negotiated the final decree in the Dinkum Sands (Beaufort Sea) case and secured court approval of the decree. As a result, Alaska received its share of escrowed funds and Alaska's title to disputed lands was quieted.

Oil and Gas Litigation and Legal Services
BRU Financial Summary by Component

All dollars in thousands

	FY2000 Actuals				FY2001 Authorized				FY2002 Governor			
	General Funds	Federal Funds	Other Funds	Total Funds	General Funds	Federal Funds	Other Funds	Total Funds	General Funds	Federal Funds	Other Funds	Total Funds
Formula Expenditures None.												
Non-Formula Expenditures												
Oil & Gas Litigation	3,908.9	0.0	1,477.0	5,385.9	3,209.7	0.0	1,477.0	4,686.7	2,959.7	0.0	1,477.0	4,436.7
Oil & Gas Legal Services	370.3	0.0	0.0	370.3	295.7	0.0	0.0	295.7	295.7	0.0	0.0	295.7
Totals	4,279.2	0.0	1,477.0	5,756.2	3,505.4	0.0	1,477.0	4,982.4	3,255.4	0.0	1,477.0	4,732.4

Oil and Gas Litigation and Legal Services

Proposed Changes in Levels of Service for FY2002

No service changes.

Oil and Gas Litigation and Legal Services

Summary of BRU Budget Changes by Component

From FY2001 Authorized to FY2002 Governor

All dollars in thousands

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
FY2001 Authorized	3,505.4	0.0	1,477.0	4,982.4
Adjustments which will continue current level of service:				
-Oil & Gas Litigation	-250.0	0.0	0.0	-250.0
FY2002 Governor	3,255.4	0.0	1,477.0	4,732.4