

State of Alaska FY2004 Governor's Operating Budget

Department of Law Oil, Gas and Mining Component Budget Summary

Component: Oil, Gas and Mining

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Component Mission

Mission statement appears at the department summary level.

Component Services Provided

The Oil, Gas, and Mining section is responsible for in-house Department of Law services in oil, gas, and mining-related disputes:

- legal representation to state agencies for the investigation, defense, and prosecution of claims concerning the state's oil and gas royalty and taxation programs, including paralegal services, data collection and processing to support the litigation effort;
- monitoring and protesting tariffs charged for transportation of oil and gas production through pipelines; and
- legal advice to state agencies concerning the development of state oil, gas, and mineral resources

Department attorneys must frequently rely on economists, engineers, and other experts to assist in the development of these highly technical oil and gas cases. Moreover, due to the complexity, length, and magnitude of major tax, royalty, tariff, and antitrust cases, outside counsel is sometimes used to help litigate these disputes.

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 & Mining component appropriation also funds legal services related to these and other oil and gas development issues. These services include tariff monitoring and disputes with the owners of TAPS and other oil pipelines in Alaska, and the assessment and collection of unpaid royalties and taxes from oil and gas producers. The contracts with outside counsel and expert consultants on large or complex oil and gas cases are also funded by this appropriation, as are the 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.

OIL 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 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. Phase I of this hearing was completed in August, 2001, and a decision is expected any time. Following the decision, Phase II of the hearing will commence. As a major rate case, the matter requires significant assistance from contract counsel and experts.

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 shippers and the state 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. This case is currently scheduled for a lengthy administrative hearing to begin in October, 2002.

The state also has begun litigation over the tariffs filed by BP for the Northstar Pipeline, a feeder pipeline to TAPS. This case is scheduled for a hearing before the Federal Energy Regulatory Commission in October, 2003.

Renewal of the TAPS right-of-way lease, which expires in 2004, is a major project that has required and will continue to require significant attention and resources. Together with Alyeska and the federal government, the state has evaluated the TAPS' owners' compliance with the existing lease terms. The commissioner of the Department of Natural Resources has issued a preliminary determination authorizing a 30-year lease renewal. The department will assist DNR in preparation of the final determination and the lease, and will assist in any challenges or appeals to the agency's action.

GAS PIPELINE-RELATED ISSUES

The department will also provide legal assistance to the Departments of Revenue and Natural Resources, among others, in support of the Alaska North Slope natural gas development project. This is likely to include (1) assisting these departments in crafting proposals for changes to the state's tax and royalty regimes in response to producer requests for greater fiscal certainty; (2) drafting legislative or regulatory language necessary to implement any changes to the state's fiscal regime or other state laws that will improve the viability of the project; and (3) assisting DNR and other agencies with their various permitting responsibilities related to the project.

In addition, after the producers file an application for a certificate of public convenience and necessity with the Federal Energy Regulatory Commission, this department will be responsible for representing the state's interests in the project before that agency. Both in-house and outside counsel will be used in this endeavor. Energy legislation currently before the U.S. Congress could influence whether the producers will proceed with a pipeline project during FY 2004, and the timing of design and permitting work.

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, 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 weeks. At this time, one tax case is in an intensive discovery stage for a hearing scheduled for August, 2003. There is a strong possibility that at least one more case will also proceed to hearing. Nevertheless, the department will be expending far less money on these cases in FY2004 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 complex property tax cases involving oil and gas properties during FY2004. These cases may 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, producers have reopened negotiations over the previously settled Alaska North Slope royalty disputes based on changes in marketplace value and transportation costs. The department will require assistance from some of the outside attorneys and experts originally involved in the royalty dispute.

The services provided under this component are described in the Oil and Gas Litigation and Legal Services BRU, except for Mining and Ethics services, which are described below.

MINING

The section also undertakes representation of the Department of Natural Resources, Division of Mining, in all legal matters. However, the mining work is not funded by the intra-agency receipts from the Oil and Gas Litigation and Legal Services BRU; it is funded instead with general funds as part of our natural resources efforts. The matters include ongoing litigation regarding mineral royalties, mining rights, and rights regarding surface occupancy of mining claims. Department attorneys also assist the division in complying with federal statutes regulating surface mining, including legal review for the use of reclamation funds, and drafting agreement with operators to insure compliance with state and federal reclamation requirements. The department also advises and assists the Department of Natural Resources' Division of Mining in drafting bonding agreements, permits, leases, best interest findings, proposed legislation, and regulations.

ETHICS

Administration of the Executive Branch Ethics Act is also provided by the section. As with mining legal matters, ethics-related work is not funded by the Oil and Gas Litigation and Legal Services BRU. When possible, such services are billed to the client agency involved, or funded with the Department of Law's general funds. The ethics attorney in the section provides advice and training to executive branch agencies and boards and commissions on the Act; advises former employees on their responsibilities under the act; investigates ethics complaints; works with designated supervisors to resolve complaints; if necessary, prosecutes ethics violations before the Personnel Board; and handles any appeals of board decisions.

Component Goals and Strategies

To ensure the state obtains the full amount of the tax and royalty revenues to which it is entitled from oil and gas development, by assisting the department's client agencies in enforcing the state's oil and gas royalty and taxation statutes, and regulations and agreements.

To ensure the state obtains the full amount of the tax and royalty revenues to which it is entitled from oil and gas development, by monitoring interstate and intrastate pipeline transportation expenses that reduce oil and gas valuation, litigating pipeline transportation cost disputes that cannot be resolved, negotiating reasonable pipeline transportation cost settlements, and enforcing pipeline transportation cost agreements in the event of a breach.

To ensure that state lands are developed in a manner that maximizes the value of the state's oil and gas resources to Alaska's citizens, by defending legislative and agency decisions related to that development from legal challenges.

To ensure that state lands are developed in a manner that maximizes the value of the state's oil and gas resources to Alaska's citizens, by providing client agencies with legal advice and other assistance necessary to enable them to carry out their statutory and regulatory responsibilities related to that development.

The mining attorney's goal is to insure compliance with state mining statutes and regulations.

The goal of the ethics attorney is to advise and educate executive branch agencies and employees on the Executive Branch Ethics Act.

The goal of the ethics attorney is to investigate alleged violations of the Executive Branch Ethics Act and initiate enforcement action in appropriate cases.

Key Component Issues for FY2003 – 2004

Appropriations for Oil and Gas Litigation have steadily declined from \$32.9 million in FY 1994, to \$11.9 million in FY 1997, \$4.7 million in FY2002, and to \$4.5 million in FY2003.

The amount requested for this effort 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 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, and will use outside counsel for large cases that proceed to hearing.

Although the amounts requested to pursue the state's oil and gas litigation efforts are significant, they will return substantial revenues to the state treasury. The department is careful to ensure that the state's litigation resources are managed to their best advantage. Outside counsel costs are contained by closely supervising their contracts and shifting substantial case responsibility to staff attorneys.

Major Component Accomplishments in 2002

- The department, with the Departments of Revenue and Natural Resources, collected approximately \$94 million (including interest) in back taxes and royalties owed by oil and gas companies.
- The department negotiated a settlement with the Alpine Transportation Company in which the parties agreed to a methodology for setting pipeline tariff rates for the Alpine Pipeline, a feeder line to TAPS.
- The department negotiated a settlement with Unocal that significantly increased the royalty value Unocal pays the state for Cook Inlet gas.
- The department assisted the Department of Revenue in resolving several disputes concerning property tax assessments of oil and gas properties.
- The department reviewed a proposed merger and ultimately approved a settlement, along with other states and the federal government, of an antitrust action relating to a merger of two major oil and gas companies.
- The department assisted the Department of Revenue in making significant revisions to regulations involving property and production taxes.
- The department advised the Department of Natural Resources, the Gas Pipeline Office, and other state agencies concerning a proposed natural gas pipeline from the North Slope to Alberta.

Statutory and Regulatory Authority

AS 44.23.020

Oil, Gas and Mining
Component Financial Summary

All dollars in thousands

	FY2002 Actuals	FY2003 Authorized	FY2004 Governor
Non-Formula Program:			
Component Expenditures:			
71000 Personal Services	2,166.0	2,343.0	2,383.7
72000 Travel	47.6	90.5	90.5
73000 Contractual	269.4	431.4	1,817.7
74000 Supplies	36.5	54.2	54.2
75000 Equipment	32.4	0.0	0.0
76000 Land/Buildings	0.0	0.0	0.0
77000 Grants, Claims	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
Expenditure Totals	2,551.9	2,919.1	4,346.1
Funding Sources:			
1004 General Fund Receipts	0.0	0.0	2,869.1
1007 Inter-Agency Receipts	2,551.9	2,919.1	0.0
1105 Alaska Permanent Fund Corporation Receipts	0.0	0.0	1,477.0
Funding Totals	2,551.9	2,919.1	4,346.1

Oil, Gas and Mining

Proposed Changes in Levels of Service for FY2004

The Oil and Gas Litigation and Legal Services BRU and its associated components are eliminated in this budget and funds transferred into this component. This eliminates redundancy, reduces the administrative burden to budget for and separately track costs through an intraagency receipts agreement. Some funding from the eliminated BRU was transferred to the Attorney General to fund an attorney to oversee oil and gas matters on a statewide basis.

Summary of Component Budget Changes

From FY2003 Authorized to FY2004 Governor

All dollars in thousands

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
FY2003 Authorized	0.0	0.0	2,919.1	2,919.1
Adjustments which will continue current level of service:				
-Annualize FY2003 COLA Increase for GG/GP/SS Bargaining Units	0.0	0.0	10.9	10.9
-\$75 per Month Health Insurance Increase for Non-covered Staff	14.9	0.0	0.0	14.9
-From Elimination of Oil & Gas Litigation and Legal Services BRU/Components	2,854.2	0.0	1,477.0	4,331.2
-PCN 03-0310 to Timekeeping and Support with I/A Receipts	0.0	0.0	-101.7	-101.7
Proposed budget decreases:				
-Eliminate I/A Receipts	0.0	0.0	-2,828.3	-2,828.3
FY2004 Governor	2,869.1	0.0	1,477.0	4,346.1

Oil, Gas and Mining

Personal Services Information

	Authorized Positions		Personal Services Costs	
	<u>FY2003</u> <u>Authorized</u>	<u>FY2004</u> <u>Governor</u>		
Full-time	32	33	Annual Salaries	1,910,774
Part-time	0	0	Premium Pay	0
Nonpermanent	0	0	Annual Benefits	593,426
			<i>Less 4.81% Vacancy Factor</i>	(120,500)
			Lump Sum Premium Pay	0
Totals	32	33	Total Personal Services	2,383,700

Position Classification Summary

Job Class Title	Anchorage	Fairbanks	Juneau	Others	Total
Accounting Clerk II	0	0	1	0	1
Analyst/Programmer IV	1	0	0	0	1
Assoc Attorney I	1	0	0	0	1
Assoc Attorney II	2	0	0	0	2
Attorney IV	7	0	3	0	10
Attorney V	2	0	2	0	4
Data Processing Mgr I	0	0	1	0	1
Data Processing Tech I	1	0	0	0	1
Law Office Assistant I	3	0	1	0	4
Law Office Assistant II	0	0	1	0	1
Paralegal II	3	0	2	0	5
Procurement Spec III	0	0	1	0	1
Secretary	0	0	1	0	1
Totals	20	0	13	0	33