

# **State of Alaska FY2009 Governor's Operating Budget**

## **Department of Law Oil, Gas and Mining Component Budget Summary**

**Component: Oil, Gas and Mining**

**Contribution to Department's Mission**

The Oil, Gas and Mining section provides advice and representation to various departments and agencies of state government to assist them in the performance of their functions.

**Core Services**

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

1. legal representation to state agencies for the investigation, defense, and prosecution of claims concerning the state's oil and gas royalty and taxation programs;
2. monitoring and protesting tariffs charged for transportation of oil and gas production through pipelines; and
3. 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 address these highly technical oil and gas issues. Moreover, due to the complexity, length, and magnitude of major tax, royalty, tariff, and antitrust cases, outside counsel must sometimes be used to help in 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 TransAlaska 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, Gas and Mining component 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 component, 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.

<b>FY2009 Resources Allocated to Achieve Results</b>		
<b>FY2009 Component Budget: \$14,257,700</b>	<b>Personnel:</b>	
	Full time	28
	Part time	0
	<b>Total</b>	<b>28</b>

**Key Component Challenges**

**OIL AND GAS PIPELINE-RELATED MATTERS**

The Oil, Gas, and Mining section expends substantial resources to monitor the TransAlaska Pipeline System (TAPS) owners' compliance with the 1985 TAPS settlement agreement, and to monitor and participate where appropriate in state and federal regulatory oversight of the tariffs of all common carrier oil and gas pipelines operating in the state. This vigilance can earn the state millions of dollars in royalties and production taxes each year. Further, as production of oil and gas from current developments declines in Alaska, the state's participation in tariff regulation is becoming more and

more important in encouraging additional producers to invest in exploration of new areas in the state, by ensuring fair transportation rates and access to existing pipeline infrastructure for production from new fields.

During FY2009 the Oil, Gas and Mining section will be briefing and participating in post-hearing proceedings stemming from the state's discrimination challenge to the TAPS' 2005 -2006 interstate tariffs. Those proceedings are likely to include the appeal of the Federal Energy Regulatory Commission (FERC) decision to the DC Circuit of the US Court of Appeals. The State will also examine the TAPS carriers' proposed 2009 tariffs and consider whether we will file a protest. The State will continue renegotiation efforts on the TAPS Interstate and Intrastate Settlement Agreements that were executed in 1985 and expire by their terms in 2011. Finally, the State's protest of expenditures by the TAPS' carriers on the Strategic Reconfiguration project will proceed through discovery and hearing processes at the FERC through FY2009.

The section will be reviewing proposed substantial revisions to current tariff terms and conditions of the Cook Inlet Pipeline and will proceed with negotiation or litigation of issues in those matters. The section will review proposed revisions to tariffs for the Kuparuk Pipeline and may negotiate or litigate these issues in those matters. The section will also continue to monitor the tariffs of other North Slope feeder pipelines that transport oil from remote fields to TAPS.

The section will continue working on cases involving disputes among TAPS shippers and the state over which methods to determine quality bank adjustments, which are payments made to compensate for the different qualities of crude oil and refinery return streams that are commingled in TAPS. These cases, in the US Court of Appeals for the DC Circuit and the Alaska Superior Court, concern decisions of the FERC and Regulatory Commission of Alaska (RCA).

The section provides support and represents the Pipeline System Integrity Office (PSIO), which oversees the maintenance of facilities, equipment, and infrastructure for the sustained production and transportation of oil and natural gas resources in Alaska, in cooperation with other state and federal agencies.

The section continues to assist the Department of Natural Resources with determining whether certain pipelines are a gathering or transportation function for purposes of determining allowable royalty deductions.

#### NORTH SLOPE GAS PIPELINE-RELATED ISSUES

The section will continue to assist in arrangements to construct a gasline to transport Alaska North Slope gas to market. The known gas resource on Alaska's North Slope is huge. The potential gas resource on unexplored lands on the North Slope is much larger. Developing this resource is one of the most promising opportunities to strengthen and support Alaska's economic future. The section will continue to work closely with the Governor's office and the Departments of Natural Resources and Revenue to provide legal assistance in implementation of the Alaska Gasline Inducement Act (AGIA) license process, including providing analysis on relevant constitutional and other state law issues.

The section provides legal support to the Alaska Natural Gas Development Authority (ANGDA) created by citizen's initiative in the November 2002 statewide election. ANGDA is charged with the task of getting North Slope natural gas to Alaskan communities as well as identifying feasible Liquefied Natural Gas opportunities. The section assists ANGDA with contract review and other legal tasks.

#### TAX CASES

This section 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, hundreds of thousands of documents are being examined, many potential witnesses must be interviewed or deposed, and experts retained in order to prepare for hearing. These hearings can last for several weeks. At this time, there are two major tax cases before the Office of Administrative Hearings. Another major case, which is at the informal conference stage, is an appeal of the department of Revenue's decision to aggregate properties within the Prudhoe Bay Unit for purposes of determining the Economic Limit Factor (ELF). The ELF appeal stems from a January 2005 decision by the Department of Revenue to aggregate six satellite producing areas with the Prudhoe Bay producing areas for purposes of calculating the ELF. The effect of this decision was to increase North Slope production taxes significantly. The impact of this decision was limited to a total of 14 months because the ELF was repealed by the amendments made to the state's production tax laws in 2006.

The section also provides support and represents the Department of Revenue in appeals from the annual oil and gas property tax assessments, including the valuation of TAPS for taxes due. The owners of TAPS appealed the department of Revenue's 2006 and 2007 assessments of TAPS to the superior court and two affected municipalities cross-appealed.

The parties have concluded an extensive round of preliminary briefing and are engaged in discovery, which is expected to last through at least the middle of calendar year 2008. Trial, originally scheduled for February 2008, is unlikely to take place until February 2009. The division will contract with experts in petroleum engineering and in appraisal and assessment practices to help prepare for trial and testify on behalf of the State.

The section will be required to provide substantial legal assistance to the department of Revenue in its development and adoption of regulations stemming from enactment of the Petroleum Production Tax (PPT) legislation and, possibly, amendments to the production tax statutes.

#### ROYALTY CASES

Royalty disputes regularly arise between the oil and gas producers and the state. Although the section handles most of these disputes in-house, assistance from outside counsel and experts is sometimes necessary. In FY2009, either the state or its lessees may reopen negotiations over the previously settled Alaska North Slope royalty disputes based on changes in marketplace value and transportation costs. The adequacy of several producers' prior royalty payments may also be the subject of arbitration proceedings. The department may require assistance from specialized outside trial counsel and experts originally involved in the royalty dispute to resolve these reopeners.

The section continues to assist the Department of Natural Resources with recouping royalty and interest owed due to inappropriate deductions taken for gas storage costs.

#### LEASING

The section continues to assist the Department of Natural Resources in multiple litigation resulting from the department's decision to find the lessees of the Point Thomson Unit in default for failure to develop or produce the Unit. The department's decision, which resulted in termination of the unit, was appealed by the lessees to superior court and almost certainly will be appealed to the Alaska Supreme Court.

#### MINING

The section assists the Department of Natural Resources in litigation regarding mineral royalties, mining rights, and rights regarding surface occupancy of mining claims. The section also assists the Department of Natural Resources 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. Additionally, the section advises and assists the Division of Mining in drafting bonding agreements, permits, leases, best interest findings, proposed legislation, and regulations.

#### MISCELLANEOUS

The section provides support and represents the Department of Revenue regarding the March and August 2006 oil spills and subsequent shutdown of the Prudhoe Bay operating area. The section is analyzing possible liability and economic damages issues related to the spills and shutdown and, if the state decides to pursue litigation, it may occur during FY2009.

The section advises and represents the Alaska Oil and Gas Conservation Commission (AOGCC) with respect to all aspects of AOGCC's oversight of oil and gas drilling, development, production, and metering and reservoir depletion. The oversight is intended to prevent waste, maximize ultimate recovery, protect correlative rights, and protect underground freshwater. The section will continue to work with AOGCC on matters involving proposed statutory and regulatory amendments, the issuance of orders and decisions, and the conduct of hearings and enforcement actions. The section will also continue to represent AOGCC in judicial challenges to AOGCC actions.

### **Significant Changes in Results to be Delivered in FY2009**

No changes are anticipated.

### **Major Component Accomplishments in 2007**

The section assisted the Governor's office and the Departments of Natural Resources and Revenue in developing

complex legislation to induce construction of a natural gas pipeline from the North Slope to markets. The section engaged in researching and drafting legislation, analyzing constitutional and other state law issues relevant to the legislation. The section assisted the departments in implementing the resulting AGIA legislation, researching and assisting in developing a Request for Applications, and implementing regulations.

The section assisted the Department of Revenue in responding to requests under the Public Records Act from members of the Alaska Legislature for documents relating to negotiations under the Stranded Gas Development Act.

The section assisted the Department of Natural Resources in issuing its decisions finding the Point Thomson Unit (PTU) lessees in default of the PTU and represented the Department in seven appeals of that decision to the superior court. The section also successfully obtained dismissal with prejudice of ExxonMobil's lawsuit for damages as a result of the PTU termination. Although the lessees appealed the termination decisions to superior court, ExxonMobil dropped its appeal of the portion of the termination decision requiring 29,000 of the 106,000 acres in the PTU to be returned to the state for breach of drilling commitments, and paid the state \$21,500,000 for that breach.

In an attempt to circumvent the Department of Natural Resources' decision to terminate the Point Thomson Unit, ExxonMobil filed an application for compulsory unitization before the Alaska Oil and Gas Conservation Commission (AOGCC). The section testified before the AOGCC on behalf of the Department of Natural Resources and filed a motion to dismiss ExxonMobil's application.

The section represented the state in joint FERC and RCA proceedings that have resulted in favorable initial decisions regarding a key quality bank adjustment.

The section represented the state in the US Court of Appeals for the DC Circuit with respect to challenges to a FERC decision concerning the methodology for determining quality bank adjustments.

The section conducted negotiations with the US Department of Justice and most recently with the US Regional Deputy Solicitor with the approval and review of the Department of Natural Resources Division of Lands to establish an administrative offshore boundary for the National Petroleum Reserve Alaska (NPR). The administrative boundary will enable both the US and Alaska to issue oil and gas leases in close proximity to the NPR offshore boundary.

The section assisted the Department of Natural Resource in obtaining the return of two North Slope oil and gas leases held by ConocoPhillips for failure to produce or develop.

The section assisted Department of Natural Resources efforts to compel development and production from a non-producing lease with well certified as capable of production.

The section assisted the Department of Natural Resources in negotiating cost sharing agreements for net profit share leases in the Milne Point Unit.

The section assisted the Department of Natural Resources with negotiation of a potential reopener regarding the ConocoPhillips' royalty formula.

The section prepared for arbitration proceedings regarding the royalty formula for ExxonMobil oil production but was able to negotiate a settlement that netted \$30,000,000 for the State and brought destination value into line with spot price.

The section prepared for a potential legal action against Williams Corporation, a purchaser of the state's royalty oil, which was taken in kind, to collect amounts due the State as a result of the ExxonMobil reopener.

The section participated in and assisted the Department of Natural Resources in analysis and negotiations of various royalty audits.

The section represented the Department of Natural Resources in superior court appeals from various department decisions regarding the North Middle Ground Shoal unit, including preparing appeal briefs, motions to dismiss and oppositions to trial de The section assisted the Department of Revenue in complex litigation against major oil and gas producers regarding the department's decision to aggregate properties for calculating the taxpayers' production tax.

The section assisted the Department of Revenue in preparing for administrative hearing on several tax appeals, including filing substantive motions and reviewing several hundreds of thousands of documents.

The section assisted the Department of Revenue in analyzing and drafting complex legislation related to fundamental changes to the state's oil and gas production tax regime.

The section assisted the Department of Revenue in negotiating a settlement with a major oil and gas producer that resulted in the producer paying over \$11 million in additional production tax and interest to the state.

The section assisted the Department of Revenue in property tax hearings before the State Assessment Review Board that resulted in the owners of the TransAlaska Pipeline System paying \$93 million in additional property taxes.

### Statutory and Regulatory Authority

AS 44.23.020

Contact Information
<p><b>Contact:</b> Tina Kobayashi, Chief Assistant Attorney General <b>Phone:</b> (907) 465-3600 <b>Fax:</b> (907) 465-2417 <b>E-mail:</b> tina.kobayashi@alaska.gov</p>

**Oil, Gas and Mining  
Component Financial Summary**

*All dollars shown in thousands*

	FY2007 Actuals	FY2008 Management Plan	FY2009 Governor
<b>Non-Formula Program:</b>			
<b>Component Expenditures:</b>			
71000 Personal Services	2,619.6	2,517.6	2,551.9
72000 Travel	88.0	79.2	79.2
73000 Services	7,756.9	1,972.4	11,572.4
74000 Commodities	45.1	54.2	54.2
75000 Capital Outlay	14.3	0.0	0.0
77000 Grants, Benefits	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
<b>Expenditure Totals</b>	<b>10,523.9</b>	<b>4,623.4</b>	<b>14,257.7</b>
<b>Funding Sources:</b>			
1004 General Fund Receipts	6,303.3	3,146.4	3,180.7
1007 Inter-Agency Receipts	2,743.6	0.0	0.0
1105 Alaska Permanent Fund Corporation Receipts	1,477.0	1,477.0	1,477.0
1197 Alaska Capital Income Fund	0.0	0.0	9,600.0
<b>Funding Totals</b>	<b>10,523.9</b>	<b>4,623.4</b>	<b>14,257.7</b>

**Estimated Revenue Collections**

Description	Master Revenue Account	FY2007 Actuals	FY2008 Management Plan	FY2009 Governor
<b>Unrestricted Revenues</b>				
None.		0.0	0.0	0.0
<b>Unrestricted Total</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Restricted Revenues</b>				
Interagency Receipts	51015	2,743.6	0.0	0.0
Permanent Fund Earnings Reserve Account	51373	1,477.0	1,477.0	1,477.0
<b>Restricted Total</b>		<b>4,220.6</b>	<b>1,477.0</b>	<b>1,477.0</b>
<b>Total Estimated Revenues</b>		<b>4,220.6</b>	<b>1,477.0</b>	<b>1,477.0</b>

**Summary of Component Budget Changes  
From FY2008 Management Plan to FY2009 Governor**

*All dollars shown in thousands*

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
<b>FY2008 Management Plan</b>	<b>3,146.4</b>	<b>0.0</b>	<b>1,477.0</b>	<b>4,623.4</b>
<b>Adjustments which will continue current level of service:</b>				
-FY 09 Health Insurance Increases for Exempt Employees	3.3	0.0	0.0	3.3
-FY 09 Bargaining Unit Contract Terms: General Government Unit	31.0	0.0	0.0	31.0
<b>Proposed budget increases:</b>				
-Multi-Year Gas Pipeline and Other Oil and Gas Projects	0.0	0.0	9,600.0	9,600.0
<b>FY2009 Governor</b>	<b>3,180.7</b>	<b>0.0</b>	<b>11,077.0</b>	<b>14,257.7</b>

**Oil, Gas and Mining  
Personal Services Information**

Authorized Positions		Personal Services Costs		
<u>FY2008</u>				
<u>Management</u>		<u>FY2009</u>		
<u>Plan</u>		<u>Governor</u>		
Full-time	27	28	Annual Salaries	1,786,655
Part-time	0	0	COLA	31,375
Nonpermanent	0	0	Premium Pay	0
			Annual Benefits	866,356
			<i>Less 4.94% Vacancy Factor</i>	(132,486)
			Lump Sum Premium Pay	0
<b>Totals</b>	<b>27</b>	<b>28</b>	<b>Total Personal Services</b>	<b>2,551,900</b>

**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	1	0	2
Assoc Attorney II	1	0	0	0	1
Attorney III	1	0	1	0	2
Attorney IV	4	0	2	0	6
Attorney V	4	0	1	0	5
Attorney VI	0	0	1	0	1
Data Processing Mgr I	0	0	1	0	1
Law Office Assistant I	2	0	2	0	4
Paralegal I	2	0	0	0	2
Paralegal II	1	0	0	0	1
Procurement Spec III	0	0	1	0	1
<b>Totals</b>	<b>17</b>	<b>0</b>	<b>11</b>	<b>0</b>	<b>28</b>