

State of Alaska
FY2010 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 legal advice and representation to state departments, boards, and commissions to insure that the state receives the maximum benefit from development of its oil, gas, and mining resources.

Core Services

- The Oil, Gas, and Mining Section provides legal advice and assistance to the state on oil, gas, and mining-related disputes. The section also advises state agencies on oil and gas royalty and tax programs and on development of state oil, gas, and mining resources. The section monitors and protests 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 address these highly technical oil and gas issues. Due to the complexity, length, and magnitude of major tax, royalty, and tariff cases, department attorneys sometimes use outside law firms to help in these disputes.
- The section funds legal services to ensure the integrity of the state's fiscal system, including issues related to Alaska North Slope crude oil destination values, allowable transportation costs, and corporate income because most of the state's operating revenues are derived from oil and gas corporate and production taxes and royalties on Alaska North Slope crude oil.
- The section funds legal services related to other oil and gas development issues including tariff monitoring and disputes with the owners of TransAlaska Pipeline System (TAPS) and other oil pipelines in Alaska, and assessment and collection of unpaid royalties and taxes from oil and gas producers.
- The section funds contracts with outside counsel and expert consultants on large or complex oil and gas cases as well as 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.

FY2010 Resources Allocated to Achieve Results

FY2010 Component Budget: \$11,279,400

Personnel:

Full time	29
Part time	0
Total	29

Key Component Challenges

OIL AND GAS PIPELINE-RELATED MATTERS

The Oil, Gas, and Mining Section expends substantial efforts to monitor the TransAlaska Pipeline System (TAPS) tariffs 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 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 FY 2010 the Oil, Gas and Mining Section will be briefing and participating in post-hearing proceedings and appeals stemming from the decision by the Federal Energy Regulatory Commission (FERC) on the TAPS 2005 and

2006 tariffs, and continue the litigation process in protest of the 2007 and 2008 TAPS tariffs. The State will also examine the TAPS carriers' proposed 2010 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 FY 2010.

The section will proceed with litigation over tariff terms and conditions of the Cook Inlet Pipeline filed in FY 2008 and the Kuparuk Pipeline tariff litigation filed in FY 2009. The section will also continue to monitor the tariffs of other North Slope feeder pipelines that transport oil from remote fields to TAPS and of Cook Inlet area oil and gas pipelines.

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.

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, 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 is a major corporate income tax case and a number of smaller tax cases before the Office of Administrative Hearings. A major production tax 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 section is representing the Department of Revenue in a trial before the Alaska superior court over the State Assessment Review Board's 2006 and 2007 property tax valuation of TAPS. The trial is scheduled for February 2009. Again, millions of dollars are a stake in the litigation. The section has contracted 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 Alaska's Clear and Equitable Share (ACES) legislation.

The section will also assist the Department of Revenue as it considers whether to propose modifications to the Mineral Licensing Tax.

ROYALTY CASES

A significant amount of section resources are spent ensuring that the state receives its fair share of royalties and net profit share from production of Alaska oil and gas resources. Much of the work is transactional in nature and concerns negotiating modifications to existing Royalty Settlement Agreements (RSAs), audits, and claims. The section assists the Department of Natural Resources to analyze transportation costs, sales data, RSAs, and the law to determine whether correct royalties and net profit share are being paid. The state has RSAs with all the major producers that cover most of the DL-1 leases in production as of the early 1990s. These RSAs all contain formulas for determining the state's royalty share. These formulas may be modified through an arbitrations proceeding called a reopener. The section deals with several reopeners a year. Currently, there is one major reopener trial scheduled for FY 2009, and at least one other reopener scheduled to be initiated. In addition, the state has begun preparations for reopeners that will be initiated in late FY 2009 or early FY 2010. Reopeners often result in a change in the price due under state contracts to sell its Royalty in Kind oil, and this change results in additional negotiations or litigation. The state has a least one Royalty In Kind collection matter scheduled for FY 2009.

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.

UNITIZATION, PARTICIPATING AREAS, AND LEASE DEVELOPMENT

The section assists the Department of Natural Resources with bringing state leases into production. This involves a multitude of different issues associated with unitization, participating area formation, farm-out agreements, and lease and tract operations. These issues generate many negotiations and appeals every year. Although there are multiple proceedings in this category, including two pending proceedings in the Alaska Supreme Court regarding Cook Inlet development, the most high profile matter in this category involves the North Slope Point Thomson Unit (PTU) litigation. In 2005, the Department of Natural Resources defaulted the PTU for failure to commit to production notwithstanding massive hydrocarbon reserves that had been know for decades. The PTU matter involves the following current proceedings: Alaska Supreme Court Appeal, eight Appellate Rule 602 appeals to the superior court, and one administrative proceeding before the Department of Administration, all regarding unit termination. In addition, more than 30 administrative appeals are pending before the Department of Natural Resources' commissioner on the lease termination.

LEASING

The section assists the Department of Natural Resources in a variety of leasing issues every year from lease sales and protests to drafting and negotiating lease terms. One major project just completed was the creation of a geothermal lease form for use in the Mount Spur geothermal lease area. The section gathered lease forms from different states and the federal government and assisted DNR with the drafting of the form lease.

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.

ALASKA OIL AND GAS CONSERVATION COMMISSION

The section advises and represents the Alaska Oil and Gas Conservation Commission (AOGCC) with respect to all aspects of the agencies 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.

MISCELLANEOUS

The section represents the State 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 FY 2010.

Section resources were also committed to completion of the negotiations with the U.S. Regional Solicitor for a supplemental decree in the U.S. Supreme Court case of U.S. v. Alaska No. 84 Original to establish a leasing boundary for the National Petroleum Reserve Alaska (NPRA). The NPRA coastal boundary is ambulatory and the administrative lease line will allow the state and federal governments to issue oil and gas leases without fear that the line will move in a way that will impair title to issued leases.

Significant Changes in Results to be Delivered in FY2010

No changes are anticipated.

Major Component Accomplishments in 2008

The section assisted the Governor's Office and the Departments of Natural Resources and Revenue in implementing the Alaska Gas Inducement Act (AGIA). The section assisted the departments with reviewing license applications for compliance with AGIA and the Request for Applications, developing the Commissioners' Findings and Determination, and obtaining legislative approval to issue the AGIA license. Also in FY 2008, section attorneys began considering the legal issues that will be involved in implementing the license.

The section represented the Department of Natural Resources in court proceedings which affirmed key components of the agency Point Thomson Unit decisions and assisted in remand proceedings to the agency for additional consideration of remedy. The section assisted in the Department of Natural Resources decisions on remand. During the period Lessees paid the state \$20,000,000 for failure to drill and it will not be certain until September 4, 2008, but, it appears that Lessees will relinquish approximately 29,000 acres of leases.

The section also represented the Department of Natural Resources in superior court proceedings that upheld Department of Natural Resources' Cook Inlet decisions on appeal and in briefing those appeals to the Alaska Supreme Court.

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.

On June 20, 2008, the FERC issued a final Opinion and Order in the TAPS interstate tariff litigation. The Department of Revenue estimates that the resulting refund will benefit the State in an amount exceeding \$200 million dollars.

The section represented the state in joint FERC and RCA proceedings that resulted in favorable 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 assisted the Department of Natural Resources with negotiation of a potential reopener regarding the ConocoPhillips' royalty formula.

The section assisted the Department of Natural Resources in negotiating resolution of a British Petroleum royalty audit for the period 2000 through 2004 that resulted in a payment to the state of more than \$30,000,000.

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. 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 represented the Department of Revenue in a major corporate income tax appeal that culminated in a two-week administrative hearing.

The section represented the Department of Revenue, Tax Division, in three tax appeals brought by the City of Valdez protesting annual oil and gas property tax assessments. In one appeal, the Office of Administrative Hearings affirmed the Tax Division's assessment. Valdez has appealed to superior court, where the section is representing the Department of Revenue. The two remaining tax appeals are pending before the Office of Administrative Hearings.

The section successfully intervened on behalf of the State in the U.S. District Court opposing attempts by environmental groups to prevent seismic activity in the Beaufort and Chukchi Seas. The District Court denied the environmental groups' request for injunctive relief. The groups filed an emergency appeal with the Ninth Circuit but the Ninth Circuit affirmed the District Court's decision.

The section represented the Department of Natural Resources in an appeal to superior court protesting a mineral closing order. After reviewing the parties' appeal briefs, the superior court affirmed the agency's decision.

The section assisted the Department of Natural Resources in drafting the 2008 Best Interest Finding for the North Slope oil and gas area wide lease sale. The section also assisted the Department of Natural Resource in analyzing and drafting a response to the North Slope Borough's reconsideration request.

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 \$379 million in additional corporate income tax and interest to the state.

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 \$7.9 million in additional corporate income 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 owing \$127 million in additional oil and gas property tax, of which the state would receive \$58.7 and the municipalities and unincorporated boroughs throughout the state would receive the remainder.

Statutory and Regulatory Authority

AS 44.23.020

Contact Information

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

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

All dollars shown in thousands

	FY2008 Actuals	FY2009 Management Plan	FY2010 Governor
Non-Formula Program:			
Component Expenditures:			
71000 Personal Services	2,556.4	2,708.5	2,814.4
72000 Travel	80.4	79.2	79.2
73000 Services	2,091.1	8,472.4	8,331.6
74000 Commodities	53.0	54.2	54.2
75000 Capital Outlay	30.4	0.0	0.0
77000 Grants, Benefits	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
Expenditure Totals	4,811.3	11,314.3	11,279.4
Funding Sources:			
1004 General Fund Receipts	3,334.3	9,837.3	9,802.4
1105 Alaska Permanent Fund Corporation Receipts	1,477.0	1,477.0	1,477.0
Funding Totals	4,811.3	11,314.3	11,279.4

Estimated Revenue Collections

Description	Master Revenue Account	FY2008 Actuals	FY2009 Management Plan	FY2010 Governor
Unrestricted Revenues				
None.		0.0	0.0	0.0
Unrestricted Total		0.0	0.0	0.0
Restricted Revenues				
Permanent Fund Earnings Reserve Account	51373	1,477.0	1,477.0	1,477.0
Restricted Total		1,477.0	1,477.0	1,477.0
Total Estimated Revenues		1,477.0	1,477.0	1,477.0

**Summary of Component Budget Changes
From FY2009 Management Plan to FY2010 Governor**

All dollars shown in thousands

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
FY2009 Management Plan	9,837.3	0.0	1,477.0	11,314.3
Adjustments which will continue current level of service:				
-FY2010 Wage and Health Insurance Increases for Bargaining Units with Existing Agreements	105.9	0.0	0.0	105.9
-Remove Oil and Gas Development Transfer from the Office of the Governor	-3,500.0	0.0	0.0	-3,500.0
-Remove Multi-Year Gas Pipeline and Other Oil and Gas Projects	-3,000.0	0.0	0.0	-3,000.0
Proposed budget increases:				
-Oil and Gas Non-Gas Pipeline Related Matters	5,109.2	0.0	0.0	5,109.2
-Gasline - Gas Pipeline	1,250.0	0.0	0.0	1,250.0
FY2010 Governor	9,802.4	0.0	1,477.0	11,279.4

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

Authorized Positions			Personal Services Costs	
	<u>FY2009</u> <u>Management</u> <u>Plan</u>	<u>FY2010</u> <u>Governor</u>		
Full-time	28	29	Annual Salaries	2,108,301
Part-time	0	0	COLA	83,186
Nonpermanent	0	0	Premium Pay	0
			Annual Benefits	1,011,837
			<i>Less 12.14% Vacancy Factor</i>	(388,924)
			Lump Sum Premium Pay	0
Totals	28	29	Total Personal Services	2,814,400

Position Classification Summary

Job Class Title	Anchorage	Fairbanks	Juneau	Others	Total
Accounting Clerk	0	0	1	0	1
Analyst/Programmer V	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	3	0	2	0	5
Attorney V	6	0	1	0	7
Attorney VI	0	0	1	0	1
Data Processing Mgr II	0	0	1	0	1
Law Office Assistant I	2	0	2	0	4
Paralegal I	1	0	0	0	1
Paralegal II	2	0	0	0	2
Procurement Spec III	0	0	1	0	1
Totals	18	0	11	0	29