

State of Alaska
FY2003 Governor's Operating Budget

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

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 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.

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.

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. 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. 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.

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. The latest information from the producers suggests that they may be prepared to file their application before the beginning of FY 03. 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, 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 appears headed for a hearing. Nevertheless, the department will be expending far less money on these cases in FY2003 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 FY2003. 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

BRU Goals and Strategies

The BRU's goals and strategies for accomplishing those goals, include:

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 to enforce 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.

Key BRU Issues for FY2002 – 2003

Appropriations for Oil and Gas Litigation have steadily declined from \$32.9 million in FY 1994, to \$11.9 million in FY 1997, \$4.9 million in FY 2001, and to \$4.7 million in FY2002.

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 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 BRU Accomplishments in 2001

- The department, with the Departments of Revenue and Natural Resources, collected approximately \$80.5 million (including interest) in back taxes and royalties owed by oil and gas companies.
- The department negotiated a settlement with the Cook Inlet Pipeline Company in which the parties agreed to a methodology for setting pipeline tariff rates for the Cook Inlet Pipeline.
- The department successfully defended at hearing the Department of Revenue's property tax assessment of the Trans Alaska Pipeline of approximately \$3 billion.
- The department successfully defended the Beaufort Sea Areawide lease sale from legal challenges brought by various environmental groups.

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

All dollars in thousands

	FY2001 Actuals				FY2002 Authorized				FY2003 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
<u>Formula Expenditures</u>	None.											
<u>Non-Formula Expenditures</u>												
Oil & Gas Litigation	2,894.5	0.0	1,477.0	4,371.5	2,868.1	0.0	1,477.0	4,345.1	2,878.4	0.0	1,477.0	4,355.4
Oil & Gas Legal Services	417.1	0.0	0.0	417.1	445.7	0.0	0.0	445.7	295.7	0.0	0.0	295.7
Totals	3,311.6	0.0	1,477.0	4,788.6	3,313.8	0.0	1,477.0	4,790.8	3,174.1	0.0	1,477.0	4,651.1

**Oil and Gas Litigation and Legal Services
Proposed Changes in Levels of Service for FY2003**

No service changes.

**Oil and Gas Litigation and Legal Services
Summary of BRU Budget Changes by Component
From FY2002 Authorized to FY2003 Governor**

All dollars in thousands

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
FY2002 Authorized	3,313.8	0.0	1,477.0	4,790.8
Adjustments which will continue current level of service:				
-Oil & Gas Legal Services	-150.0	0.0	0.0	-150.0
Proposed budget increases:				
-Oil & Gas Litigation	10.3	0.0	0.0	10.3
FY2003 Governor	3,174.1	0.0	1,477.0	4,651.1