

Oil and Gas Litigation (Non-Gasline)**FY2012 Request: \$5,000,000****Reference No: 51784****AP/AL:** Appropriation**Project Type:** Life / Health / Safety**Category:** Law and Justice**Location:** Statewide**Contact:** Dave Blaisdell**House District:** Statewide (HD 1-40)**Contact Phone:** (907)465-3673**Estimated Project Dates:** 07/01/2011 - 06/30/2016**Brief Summary and Statement of Need:**

This request is for funding for outside counsel and experts for major Oil and Gas matters including: Pt Thomson litigation, ongoing proceedings before the Federal Energy Regulatory Commission (FERC) on TransAlaska Pipeline Services (TAPS) tariffs issues; and corporate income tax matters. These funds will compliment the Department's efforts towards efficiently protecting the fiscal integrity of the State. Use of funds across these cases will depend somewhat upon the timing of litigation.

Funding:	<u>FY2012</u>	<u>FY2013</u>	<u>FY2014</u>	<u>FY2015</u>	<u>FY2016</u>	<u>FY2017</u>	<u>Total</u>
Gen Fund	\$5,000,000						\$5,000,000
Total:	\$5,000,000	\$0	\$0	\$0	\$0	\$0	\$5,000,000

<input type="checkbox"/> State Match Required	<input type="checkbox"/> One-Time Project	<input type="checkbox"/> Phased - new	<input type="checkbox"/> Phased - underway	<input checked="" type="checkbox"/> On-Going
0% = Minimum State Match % Required		<input type="checkbox"/> Amendment	<input type="checkbox"/> Mental Health Bill	

Operating & Maintenance Costs:

	<u>Amount</u>	<u>Staff</u>
Project Development:	0	0
Ongoing Operating:	0	0
One-Time Startup:	0	0
Totals:	0	0

Additional Information / Prior Funding History:

No prior capital funding.

Project Description/Justification:

- Trans Alaska Pipeline System (TAPS). The Oil, Gas, and Mining Section expends substantial efforts to monitor the 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.

In FY2012, the section will be involved in litigation challenging the inclusion of hundreds of millions of dollars in imprudent capital expenditures in the TAPS' rate base for the Strategic Reconfiguration Project. The Federal Energy Regulatory Commission (FERC) and the Regulatory Commission of Alaska (RCA) have scheduled concurrent hearings for four weeks in Anchorage followed by four weeks in Washington D.C., beginning November 1, 2011.

The section will continue the litigation process in protest of the superseding TAPS tariffs filed at

both the Federal Energy Regulatory Commission (FERC) and the Regulatory Commission of Alaska (RCA) in 2008, 2009, and 2010.

The section will proceed with litigation over tariff terms and conditions of the Kuparuk Pipeline's intrastate and interstate tariffs at the RCA and the FERC. 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 between TAPS shippers, TAPS carriers, and the state over the valuation of crude oil under the TAPS Quality Bank, which is a system for adjusting crude oil values to account for the different qualities of crude oil and refinery return streams that are commingled in the TAPS common stream. These cases, in the US Court of Appeals for the DC Circuit and the Alaska Superior Court, concern decisions of the FERC and RCA.

- Tax Cases. This section is pursuing hundreds of millions of dollars in past-due taxes, interest, and penalties that are owed by oil and gas producers and other corporate taxpayers to the state. At this time, the section is representing the Department of Revenue in an appeal to superior court by Tesoro Corporation of an Office of Administrative Hearings decision resulting in additional tax liabilities, interest, and penalties of about \$13 million. A major production tax case, which is before the Office of Administrative Hearings, 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 is also representing the Department of Revenue in a number of confidential tax disputes at the administrative level.

The section provides support and represents the Department of Revenue in appeals from the annual oil and gas property tax assessments, including the valuation of TAPS. Judge Gleason affirmed the Department of Revenue on its assessment methodology for 2006 and, based on new cost and North Slope oil reserves studies presented at trial, doubled the TAPS value to \$9.9 billion for tax year 2006. The section is representing the Department of Revenue in the appeals before the Alaska superior court over the State Assessment Review Board's 2007, 2008, 2009, and 2010 property tax valuations of TAPS. An eight-week trial on the 2007, 2008, and 2009 valuations is scheduled to begin in September 2011. The section has contracted with experts in petroleum engineering, pipeline construction costs, and appraisal and assessment practices to help prepare for trial and testify on behalf of the State.

Royalty Cases. The section represents Department of Natural Resources (DNR) in royalty disputes and works with DNR in royalty negotiations to ensure that the state receives its fair share of royalties and net profits share from production of Alaska oil and gas resources. This work also includes handling related development and production sharing disputes. Much of the work is transactional in nature and concerns negotiating modifications to existing Royalty Settlement Agreements, audits, and claims. But the section must litigate or arbitrate some claims in order to recover the amount due to the state. Litigation and arbitration inevitably involves developing expert opinions, which require a long lead time. The section manages expert witnesses that

analyze transportation costs, sales data, and royalty settlements, markets, destination values, development issues, and reservoir modeling. Legal advice is provided to DNR on a variety of related issues ranging from confidentiality to contract construction and whether royalty and net profit share payments and deductions meet legal requirements.

The state has Royalty Settlement Agreements with all the major producers that cover most of the Alaska North Slope DL-1 leases in production as of the early 1990s. These Royalty Settlement Agreements all contain formulas for determining the state's royalty share. These formulas may be modified through an arbitration proceeding called a reopener. Typically there are several reopeners a year. Currently, the section is working on a major production allocation dispute and a pending reopener. Several reopeners will be initiated during FY2011. The Royalty Settlement Agreements also provide for arbitration proceedings to resolve disputes about whether past payments were consistent with the then existing applicable agreement. The section is currently working on one of those proceedings.

- 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 known for decades. The PTU matter involves the following current proceedings: Briefing on the Alaska Supreme Court Petition for Review from reversal of the unit termination decision, a separate appeal on damages, eight Appellate Rule 602 appeals to the superior court, and one administrative proceeding before the Department of Administration, all regarding unit termination. There are also proceedings in the superior court regarding permits and Alaska Oil and Gas Conservation Commission compulsory unitization.