State of Alaska
FY2007 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:

- legal representation to state agencies for the investigation, defense, and prosecution of claims concerning the state's oil and gas royalty and taxation programs;
- 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 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 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, Gas & 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.

FY2007 Resources Allocated to Achieve Results

FY2007 Component Budget: $4,879,600

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 resources to monitor the 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 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 FY2007 the Oil, Gas & Mining section will prepare for and participate in a 4 to 5 week hearing at the FERC considering (in part) the state's and Anadarko's challenges to the TAPS 2005 FERC tariff. The section will continue negotiations with Cook Inlet area gas pipeline owners on the opening to regulated access of all Cook Inlet area gas pipeline infrastructure -- to facilitate and encourage new gas production and producers -- and will support acceptance of the tariffs developed through those negotiated settlements in proceedings at the Regulatory Commission of Alaska (RCA). The section will also continue to participate in several administrative appeals related to intrastate TAPS tariffs.

The state 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 appropriate method 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. The FERC and RCA recently issued their decisions. However, court appeals from those decisions are very likely before the case is resolved. The Oil, Gas & Mining section will continue to monitor the tariffs of the so-called North Slope feeder pipelines that transport oil from remote fields to TAPS.

Finally, the section will be involved in regulatory proceedings before the RCA relating to the development of gas storage facilities in the Cook Inlet area.

GAS PIPELINE-RELATED ISSUES

Expediting the arrangements to construct a gasline to transport Alaska North Slope gas to market sits at the top of the FY2007 Department of Law “to do” list. 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 these resources is one of the most promising opportunities to strengthen and support Alaska’s economic future.

The key to unlocking the North Slope gas resource is the construction of a pipeline to transport this gas to market. To expedite the construction of the needed gas transportation system, the state legislature enacted the Stranded Gas Development Act in its current form in 2003. The Stranded Gas Development Act provides an opportunity for the negotiation of Fiscal Contracts to tailor the state’s fiscal terms (taxes and royalties) pertinent to North Slope gas development to enhance the likelihood of the construction of the needed transportation system.

Three potential project sponsors—(1) TransCanada Corporation, (2) the major North Slope producers (ConocoPhillips, BP, and ExxonMobil) and (3) Enbridge Inc.—have applied for fiscal contracts under the Stranded Gas Development Act. In preparing this budget the Department has assumed the state will successfully negotiate a fiscal contract with at least one of the applicants. Further the Department believes the contract will provide for state ownership of some portion of the project.

During FY2007 we anticipate there will be one or more legal challenges to the constitutionality of the Stranded Gas Development Act and the legality of the contract. In addition, there will be a very large amount of on-going legal work relating to the state’s participation in financing the project and to the many commercial and technical matters that the state must deal with in such a huge enterprise including (1) assisting the Departments of Revenue and Natural Resources 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, if the successful applicant files an application for a certificate of public convenience and necessity with the Federal Energy Regulatory Commission, this section 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. The enactment of federal legislation to accelerate development of Alaska’s North Slope gas has increased significantly the demands placed on the Oil, Gas and Mining Section.

The section must also provide legal support to the Alaska Natural Gas Development Authority created by citizen's initiative in the November 2002 statewide election. This initiative is primarily focused on a proposed project to market Alaska's North Slope gas as LNG somewhere in the Pacific Rim. The challenge is to ensure that the efforts undertaken to promote this proposed project do not jeopardize the proposed Alaska Highway project.

Assuming the state successfully negotiates a Stranded Gas contract and takes an ownership interest in the project, the department estimates the amount required for FY2005 and FY2006 outside counsel gasline related legal work will deplete the $9.0 million currently appropriated by the legislature. We estimate an additional $3.9 million will be needed and are requesting the funds in the FY2007 capital budget.

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 many potential witnesses must be interviewed or deposed in order to prepare for hearing. These hearings can last for weeks. At this time, one major tax case is before the Office of Administrative Hearings, and a second major case is in the informal conferences stage. Another major case 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.

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, both the state and its lessees 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 to resolve these reopeners.

MINING

The challenges include ongoing support and/or litigation regarding mineral royalties, mining rights, and rights regarding surface occupancy of mining claims. Department attorneys also assist DNR 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 section also advises and assists the Division of Mining in drafting bonding agreements, permits, leases, best interest findings, proposed legislation, and regulations.

Significant Changes in Results to be Delivered in FY2007

The Oil, Gas and Mining section's legal assistance will improve the efficiency of our client agencies' effort to spur new resource development thereby increasing public revenue and other benefits from that development.

The business climate for resource development will improve with fair and efficient resolution of litigation pertaining to:

(1) regulatory barriers to resource development;
(2) access to existing pipeline infrastructure for new-to-Alaska oil & gas producers; and
(3) developers' tax and royalty obligations to the State of Alaska.

This litigation will also move in-state pipelines toward lower transportation rates, and thus increase state royalties and production taxes.

Major Component Accomplishments in 2005

The section participated in complex and intensive negotiations with the TransCanada Corporation and the major North Slope producers under the Stranded Gas Development Act. The section engaged in drafting detailed contract provisions and analyzing constitutional and other state law issues relevant to the contracts.

The section assisted the Departments of Revenue and Natural Resources in analyzing legislative proposals to accelerate oil and gas development in the state and modify the Economic Limit Factor.

The section, resolved a Loss reopener against a North Slope producer for approximately $4 million, and also negotiated with the same producer a partial resolution to a Destination Value reopener worth approximately $30 million. The Destination Value reopener was resolved in 2005 after trial, for a total amount of $40 million, but the final amount that the state will receive depends on the results of a pending Transportation Cost reopener which may offset to some degree the results from the other reopeners.

The section negotiated resolution of a North Slope producer net profit share audit for approximately $18 million.

The section participated in negotiations that resulted in opening sufficient pipeline access for Agrium to forestall closure of the Nikiski fertilizer plant.

Statutory and Regulatory Authority

AS 44.23.020

Contact Information

Contact: Larry Ostrovsky, Chief Assistant Attorney General
Phone: (907) 269-5100
Fax: (907) 279-8644
E-mail: Larry_Ostrovsky@law.state.ak.us

Oil, Gas and Mining
Component Financial Summary

All dollars shown in thousands

	FY2005 Actuals	FY2006 Management Plan	FY2007 Governor
Non-Formula Program:			
Component Expenditures:			
71000 Personal Services	2,371.6	2,617.2	2,764.3
72000 Travel	73.6	79.2	79.2
73000 Services	7,086.9	8,536.4	1,981.9
74000 Commodities	51.6	54.2	54.2
75000 Capital Outlay	27.2	0.0	0.0
77000 Grants, Benefits	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
Expenditure Totals	**9,610.9**	**11,287.0**	**4,879.6**
Funding Sources:			
1004 General Fund Receipts	5,896.0	9,810.0	3,402.6
1007 Inter-Agency Receipts	2,237.9	0.0	0.0
1105 Alaska Permanent Fund Corporation Receipts	1,477.0	1,477.0	1,477.0
Funding Totals	**9,610.9**	**11,287.0**	**4,879.6**

Estimated Revenue Collections

Description	Master Revenue Account	FY2005 Actuals	FY2006 Management Plan	FY2007 Governor
Unrestricted Revenues				
None.		0.0	0.0	0.0
Unrestricted Total		**0.0**	**0.0**	**0.0**
Restricted Revenues				
Interagency Receipts	51015	2,237.9	0.0	0.0
Permanent Fund Earnings Reserve Account	51373	1,477.0	1,477.0	1,477.0
Restricted Total		**3,714.9**	**1,477.0**	**1,477.0**
Total Estimated Revenues		**3,714.9**	**1,477.0**	**1,477.0**

Summary of Component Budget Changes
From FY2006 Management Plan to FY2007 Governor

All dollars shown in thousands

	General Funds	Federal Funds	Other Funds	Total Funds
FY2006 Management Plan	**9,810.0**	**0.0**	**1,477.0**	**11,287.0**
Adjustments which will continue current level of service:				
-Remove Gas Pipeline Sec 20(b) CH 3 FSSLA 2005 P 106 L 27 (SB 46) Lapses 6/30/06	-6,554.7	0.0	0.0	-6,554.7
-FY 07 Wage Increases for Bargaining Units and Non-Covered Employees	48.4	0.0	0.0	48.4
-FY 07 Health Insurance Cost Increases for Bargaining Units and Non-Covered Employees	4.9	0.0	0.0	4.9
-FY 07 Retirement Systems Cost Increase	89.1	0.0	0.0	89.1
Proposed budget increases:				
-Risk Management Self-Insurance Funding Increase	4.9	0.0	0.0	4.9
FY2007 Governor	**3,402.6**	**0.0**	**1,477.0**	**4,879.6**

Oil, Gas and Mining
Personal Services Information

Authorized Positions			Personal Services Costs	
	FY2006 Management Plan	**FY2007 Governor**	Annual Salaries	1,833,369
Full-time	29	29	COLA	48,609
Part-time	1	0	Premium Pay	0
Nonpermanent	0	0	Annual Benefits	916,085
			Less 1.21% Vacancy Factor	(33,763)
			Lump Sum Premium Pay	0
Totals	**30**	**29**	**Total Personal Services**	**2,764,300**

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	0	0	2	0	2
Attorney IV	6	0	1	0	7
Attorney V	2	0	2	0	4
Attorney VI	1	0	0	0	1
Data Processing Mgr I	0	0	1	0	1
Law Office Assistant I	2	0	2	0	4
Paralegal II	3	0	1	0	4
Procurement Spec III	0	0	1	0	1
Totals	**17**	**0**	**12**	**0**	**29**