Department of Law

Component: Oil, Gas and Mining (2091)
RDU: Civil Division (35)

Scenario/Change Record Title	Trans Type	Totals	Personal Services	Travel	Services	Commodities	Capital Outlay	Grants, Benefits	Miscellaneous	Positions PFT	PPT	NP
		***	Changes From FY2012 Supplemental To	***								
Oil and Gas Outside Counsel												
	Suppl	3,116.0	0.0	0.0	3,116.0	0.0	0.0	0.0	0.0	0	0	0
1004 Gen Fund	3,116.0											

The Oil, Gas and Mining section requests supplemental funding to continue services of outside counsel. The majority of the additional funding request is attributable to three types of cases:

Tariff Proceedings: Strategic Reconfigurations - $6,300.0
TAPS Property Tax Proceedings - $1,056.0 ($1,206.0 less $150.0 funded by DNR)
Oil & Gas Royalty Issues - $1,250.0

With the above three cases and other costs estimated to be $810.0, the total projected expenditures for oil and gas outside counsel is $9,416.0. With an operating budget of $5,000.0 and $1,300.0 available in capital funding, for a total budget of $6,300.0, the division is anticipating a $3,116.0 shortfall for FY2012. The budget for FY2013 includes $6,150.0 for anticipated caseload based on what the department knows today.

Each of the three major cases is discussed in more detail below:

Strategic Reconfigurations (Projected FY2012 costs - $6,300.0): Increased litigation costs related to the state's objection to inclusion of imprudently incurred strategic reconfiguration costs in the Trans-Alaska Pipeline System (TAPS) tariff is the biggest driver of the shortfall. The litigation arises from protests that the state filed from 2005 through the current tariff. In 2003, the TAPS owners approved the Strategic Reconfiguration Project, an 18-month, $250 million capital construction project to replace and update certain TAPS facilities. More than eight years later, the project is still not complete. Estimates for the cost of completion exceed $800 million, over three times the original budget.

This case was bi-furcated into an initial eight-week hearing which began October 31, 2011 and with scheduled breaks, is likely to end around the middle of January 2012. The second phase, estimated to last an additional four to five weeks, has not yet been scheduled but it is believed that it will start sometime in July 2012. The increase in the state's litigation cost is due, in part, to the length and location of the hearings. The Federal Energy Regulatory Commission and the Regulatory Commission of Alaska decided to break up the consolidated eight-week hearing between Anchorage and Washington D.C. The hearings were held first in Anchorage for three weeks in November, then moved to Washington D.C. for another three weeks in December, and will conclude in January with an additional week or two in Washington D.C.

The hearings and all pre- and post-hearing deadlines are set by Orders by the FERC and RCA administrative law judges. The schedule lengthened primarily due to the Owners' expansion of their defense case -- last year's budget estimate was based on the Owners' representations at that time that they would call 12 witnesses, but they filed testimony of 19 witnesses, who are primarily independent expert witnesses. The state needed to retain two additional expert witnesses and call an additional fact witness to respond to the Owners' additional witnesses. Unlike the economic issues that are the standard fare of tariff rate litigation, this prudence case relied on unique and costly engineering expert testimony in the areas of pipeline design, project scheduling, and industry standards for capital investment.

TAPS property tax proceedings (Projected FY2012 costs - $1,206.0 less $150.0 funded from DNR): The division had projected expenses for the TAPS Property Tax trial to be comparable to FY2011 but two things changed since the initial projection. First, the Department of Revenue (DOR) did not enter into an RSA for expert witness fees. Further conversations with DOR will be occurring to determine if additional funding might be available. Any changes would offset the amount of the supplemental. Second, costs to maintain the database increased substantially due to the large number of documents received in production and

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generated by the parties in motion practice (to give an idea of the scale, the judge just issued over 500 Court orders in the case). An additional $1,000.0 is needed in FY2012 to prepare for a scheduled nine-week trial de novo this fall regarding the TAPS property values for 2007-2009. At issue in this litigation was DOR property tax valuations of the TAPS for tax years 2007, 2008, and 2009 in the amounts of $4.6 billion, $6 billion and $9 billion, respectively. The judge determined that the values were $8.941 billion, $9.644 billion, and $9.249 billion, respectively, significantly higher than the $1 billion range urged by the TAPS Owners and significantly lower than the $14 billion range urged by the Municipalities.

Oil and gas royalty issues (Projected FY2012 costs - $1,250.0): There are several reasons why costs for royalty and leasing cases have increased since our estimate of the FY2012 budget last year. First, the department has received substantial funding via Reimbursable Services Agreements (RSAs) with the Department of Natural Resources (DNR) in past budget years to hire expert witnesses and contract counsel in litigation and adjusted anticipated needs accordingly. The RSA from DNR this year is significantly smaller. Further conversations with DNR will be occurring to determine if additional funding might be available. Any changes would offset the amount of the supplemental. Second, although contract counsel costs related to settlement discussions in the Point Thomson litigation were included, the settlement negotiations have intensified and become much more complex and drawn out than originally anticipated.

A $6,150.0 request is included in the FY2013 Governor's budget.

		Totals	Personal Services	Travel	Services	Commodities	Capital Outlay	Grants, Benefits	Miscellaneous	PFT	PPT	NP
	Totals	**3,116.0**	**0.0**	**0.0**	**3,116.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0**	**0**	**0**

Department of Law

Component: Transportation Section (2214)
RDU: Civil Division (35)

Scenario/Change Record Title	Trans Type	Totals	Personal Services	Travel	Services	Commodities	Capital Outlay	Grants, Benefits	Miscellaneous	Positions PFT	PPT	NP
Fast Ferry Litigation												
	Suppl	600.0	0.0	0.0	600.0	0.0	0.0	0.0	0.0	0	0	0
1004 Gen Fund	600.0											

History:
In 2001, the State executed a $68M contract with Derecktor Shipyards for the design and construction of two fast vehicle ferries (FVFs). The manufacturer of the engines that Derecktor installed, MTU, represented that the State could expect 100,000 service hours from each of the eight diesel engines (four per vessel) that powered the ferries. Contrary to what was warranted, the engines have suffered aggressive internal degradation and will not likely last much beyond 15,000 hours/engine. The State contends that Derecktor and MTU have contractual/warranty obligations to the State that require effective engine repair or replacement, while Derecktor and MTU believe improper maintenance by the State is to blame for the premature engine failures. The State has filed a breach of contract suit against both Derecktor and MTU and is requesting that Derecktor and MTU honor their obligations by either retrofitting or replacing the engines, or by paying money damages.

Case Status:
A three week jury trial is scheduled for September 2012. Three weeks is likely inadequate, and the parties will be asking the judge for one to two additional weeks. In the meantime, discovery is ongoing. The parties have already exchanged close to 100,000 pages of documents, and will begin depositions shortly. Over 40 depositions are currently planned, and that number is likely to increase. The witnesses are scattered throughout the country, so travel expenses will be incurred. Also, the preliminary injunction motion filed by the State, seeking to force the defendants to begin manufacturing new engines, remains pending. The State has asked for an evidentiary hearing on the motion, but that request has not yet been granted. Given the extremely heavy workload, the State recently retained outside counsel to assist the Attorney General's Office in handling the case.

Funding:
In FY2011, the department had $200,000 appropriated for the fast ferry litigation. FY2011 activity however exceeded the $200,000 and the department covered $19,789 while the Department of Transportation paid an additional $109,480. Total expenditures associated with the fast ferry lawsuit to date are $569,955 (including $21,605 from FY2010). In FY2012 YTD, $219,081 has been expended and it is anticipated to ramp up because outside counsel has been obtained and discovery activity will pick up.

A $600.0 increase is included in the FY2013 Governor's budget.

	Totals	Personal Services	Travel	Services	Commodities	Capital Outlay	Grants, Benefits	Miscellaneous	PFT	PPT	NP
Totals	**600.0**	**0.0**	**0.0**	**600.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0**	**0**	**0**