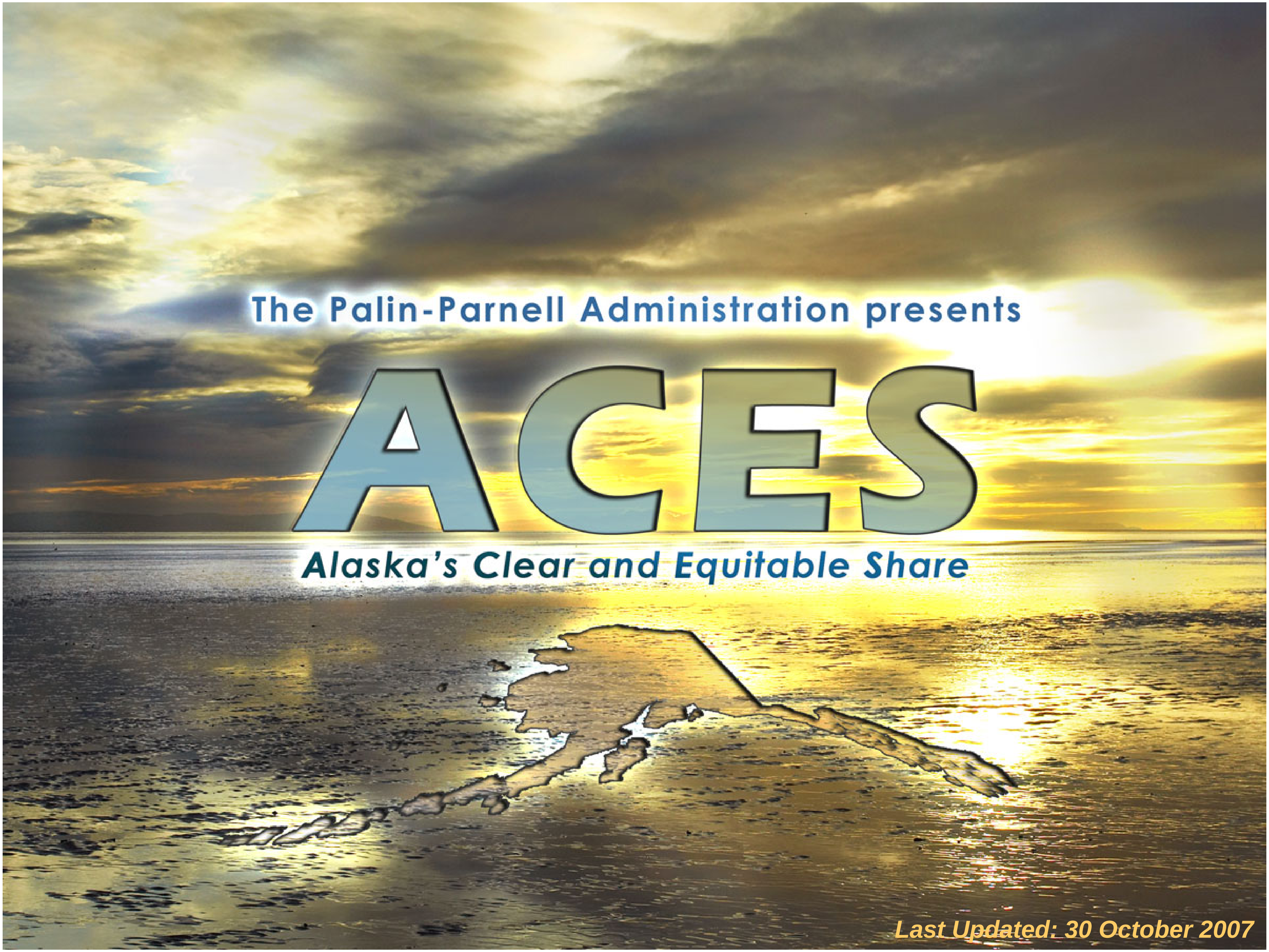
The Palin-Parnell Administration presents
ACES
Alaska's Clear and Equitable Share
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Transportation Deductions

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Overview

- Current law
- The commercial reality
- Some problems
- Potential remedies

AS 43.55.150

- Gross value at point of production determined by subtracting “reasonable costs of transportation” from market prices
- “Reasonable costs” = “actual costs”
- “Actual costs” have historically been understood as FERC/RCA tariffs
- Exception for affiliate transactions, but only if “there are other reasonable modes of transportation” → exception is never met!

Transportation Deductions (Oil Pipelines)

- Deductions have historically relied on rates sanctioned by regulatory bodies
- Typically, this “sanction” does not reflect a regulatory determination
- Rather, the regulatory bodies have “blessed” settlement agreements between the state and the pipeline owner

Issue #1

Why does state base its tax policy for pipeline transportation deductions on pipeline rate litigation?

- MMS doesn’t when pipeline is owned by producing affiliates.
  - They adopt a method promulgated through regulation

Pipeline Transportation Deductions

- Key reasons for state to avoid relying on regulatory process in setting tax value
  - Creates uncertainty: While litigation drags on tax value not fully known
  - Inefficient: Regulatory process unlikely to work well absent arms-length commercially sophisticated parties

TAPS Tariffs Example

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Background:

- TAPS rates are currently ~$5/bbl, set under a 1985-era settlement agreement between the State and the TAPS owners
- Rates don't appear to reflect "actual costs"
  - RCA determined that actual costs ~$2/bbl
  - FERC Administrative Law Judge determined that actual costs ~$2/bbl
- While litigation continues, State continues to allow a ~$5/bbl transportation deduction

TAPS Tariffs Example

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Indicative Value of "Tariffs by DOR"

- Assume:
  - TAPS tariffs are $3/Bbl too high
  - 760,000 Bbls/day
  - Production tax rate of 22.5%
  - All barrels are shipped on affiliated transportation
- Then production tax value to state of setting tariffs for affiliate transactions is **~$160 million/year**

Transportation Deductions (Gas Pipelines)

- Gas pipelines typically built on basis of “negotiated rates” between shippers and pipelines
- FERC typically gives no scrutiny as to whether the negotiated rates are a “fair” bargain between shipper and pipeline
- If Producers end up owning the gas pipeline, then they can negotiate rates with themselves

Issue #2

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Why would the state want to set its tax policy for transportation deductions on the basis of a non-arms length deal that state can't even litigate?

- Experience on TAPS suggests it would be unwise
- No compelling need to do so

The Key to a Remedy

- At present, state is arguably forced to live with non-arms length transactions because it is never the case that "there are other reasonable modes of transportation"
- DOR could follow MMS' lead and establish regulations that determine appropriate cost deductions for non arms-length transactions on pipelines
- Cleanup language needed to ensure that the arms-length shippers – who really do have "actual costs" of the posted tariffs – are not forced to use the DOR-established tax deduction