

Judge Gleason's TAPS Decision: What It Says, and What It Doesn't

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Disclaimers

- The opinions expressed here are entirely my own; not speaking on behalf of any client
- Not involved in the case, but monitored the case and studied the decision closely because of its potential impact on Alaska

Background of the Case

- State court dispute over the valuation of TAPS for property tax purposes
- Parties: Alyeska v. the North Slope Borough, Fairbanks North Star Borough and Valdez (and the Alaska Dep't of Revenue)
- Life of TAPS is relevant to TAPS economic value and accumulated depreciation
- Decision issued December 30, 2011
 - On appeal to the Alaska Supreme Court

The Decision

- Judge Sharon Gleason found that the value of TAPS for property tax purposes was \$8.94 B (2007), \$9.64 (2008), \$9.24 (2009)
- In the course of determining those values, concluded that “*the life of TAPS* based on its proven reserves and incorporating its minimum capacity throughput limitations as of ... 2007, 2008 and 2009 *is at least until 2065.*”
- Based on her conclusion that TAPS can continue to accommodate flows as low as 75,000 bbl/d

The Spin

- ***“...court ruling shows bright future for Alaska oil development”***
 - "This should ***ease the minds*** of many Alaskans as to the imminent demise of the pipeline," Paskvan said, shortly after getting a copy of the decision this afternoon. "This indicates that we have a 50-year minimum operation without considering many of the resources that are likely to be harvested from the North Slope."
 - Dermot Cole, Fairbanks Daily News-Miner, Dec. 30, 2011

The Spin Continued

- ***“Time for legislators, governor to demand straight talk on life expectancy of trans-Alaska pipeline”***
 - “... the ***good news for Alaskans*** is that numerous oil company documents and expert testimony shows there is no reason to believe the pipeline will be shut down this decade or for a long time after. To the contrary, the oil companies are booking reserves far into the future and making plans to run the pipeline at lower rates, which means more decades of operation for the pipeline.”
 - Dermot Cole, Fairbanks Daily News-Miner, Jan. 1, 2012

The Consequence

- ***“Ruling could loom large in Alaska oil tax debate”***
 - “The political part of the debate was amplified by the judge's findings that there could be a long life for the pipeline even with less oil moving through it - ***giving supporters of keeping oil taxes where they are new ammunition.***”
 - Becky Borher (AP), Fairbanks Daily News-Miner, Jan. 8, 2012

So ...

- ... should the decision *“ease the minds”* of Alaskans
- Is it ... *“good news for Alaskans”*
- Should it *“give supporters of keeping oil taxes where they are new ammunition”*

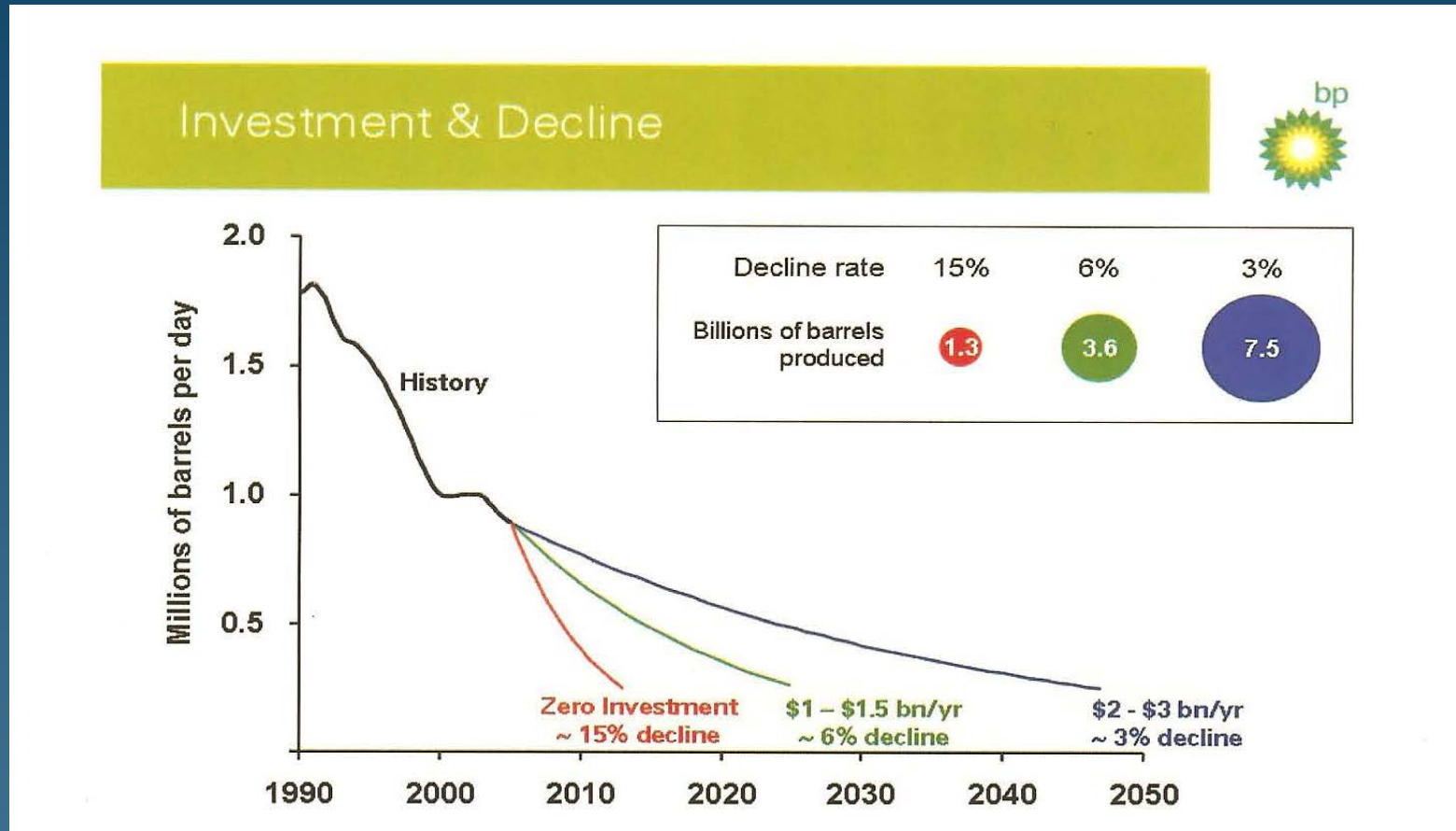
The Answer

- No

Why Not ...

- Joe Balash has it right ...
 - “Deputy Natural Resources Commissioner Joe Balash said *a 300,000-barrel a day throughput scenario ... would be a ‘disaster,’* because at that level, the state budget would be in a ‘dire deficit.’”
 - Becky Borher (AP), Fairbanks Daily News-Miner, Jan. 8, 2012 (17 paragraphs into the story).
- To paraphrase James Carville from the 1992 Presidential campaign
 - In Alaska, “It’s the production rate, stupid”
 - ... not the reserve life

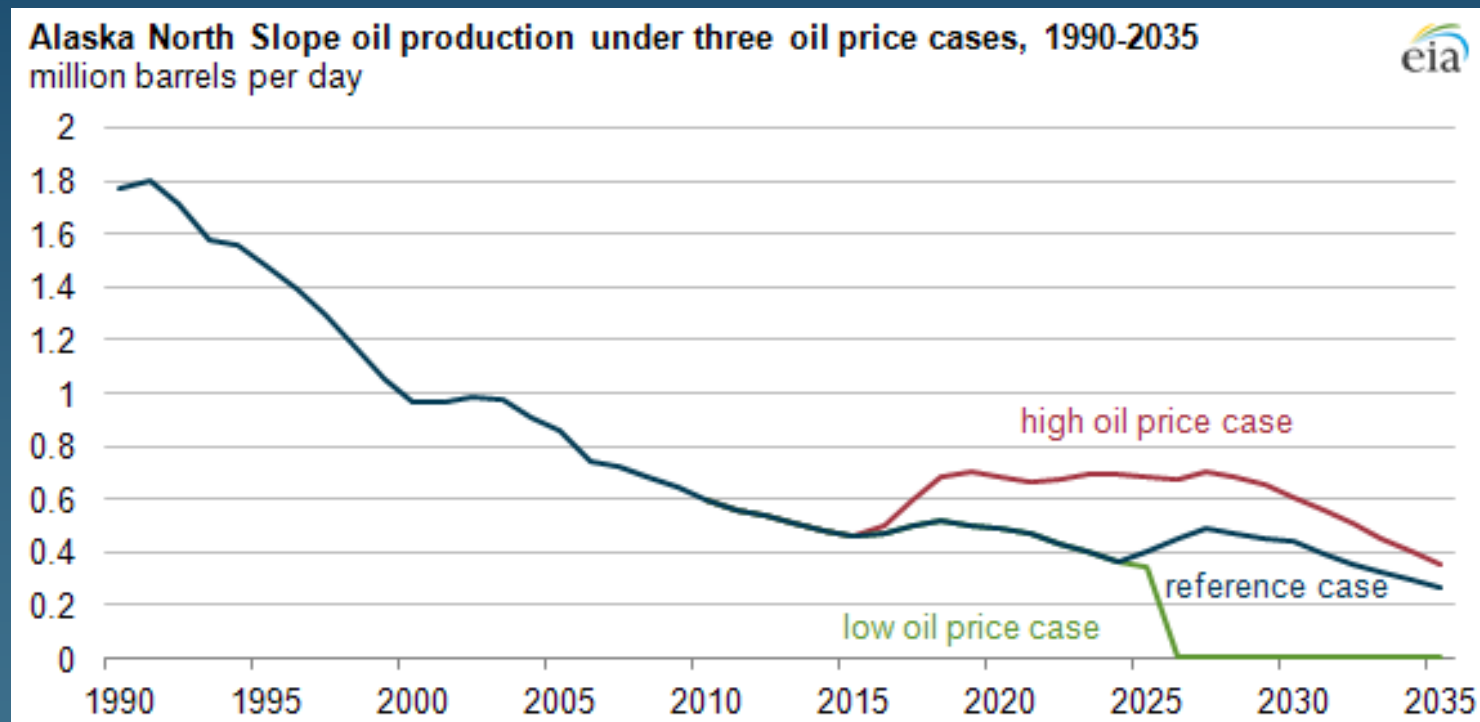
Alaska's Three Alternative Futures



Source: BP Presentation on Proposed PPT
 (Alaska State Legislature House & Senate Resources
 Committees 2006)

EIA View: 2012 Annual Energy Outlook

“Projected Alaska North Slope oil production at risk beyond 2025 if oil prices drop sharply”



Source: US Energy Information Administration

“Projected Alaska North Slope oil production at risk beyond 2025 if oil prices drop sharply,” Sept. 14, 2012

EIA View

- “TAPS ... projected lifetime *depends on continued investment* in North Slope oil production that itself depends on future oil prices.”
- “In the Annual Energy Outlook 2012 low oil price case [\$62], *North Slope production would cease and TAPS would be decommissioned, which could occur as early as 2026.*”

Source: US Energy Information Administration
“Projected Alaska North Slope oil production at risk beyond 2025 if oil prices drop,” Sept. 14, 2012

What the Decision Doesn't Say...

- ... says nothing about which decline curve Alaska is on
- ... at most, the decision merely says that the tail end of the decline curve may be extended longer than some have previously forecast
- ... says nothing about the effect of declining production on the state's economic well being

Why Is It “The production rate ...

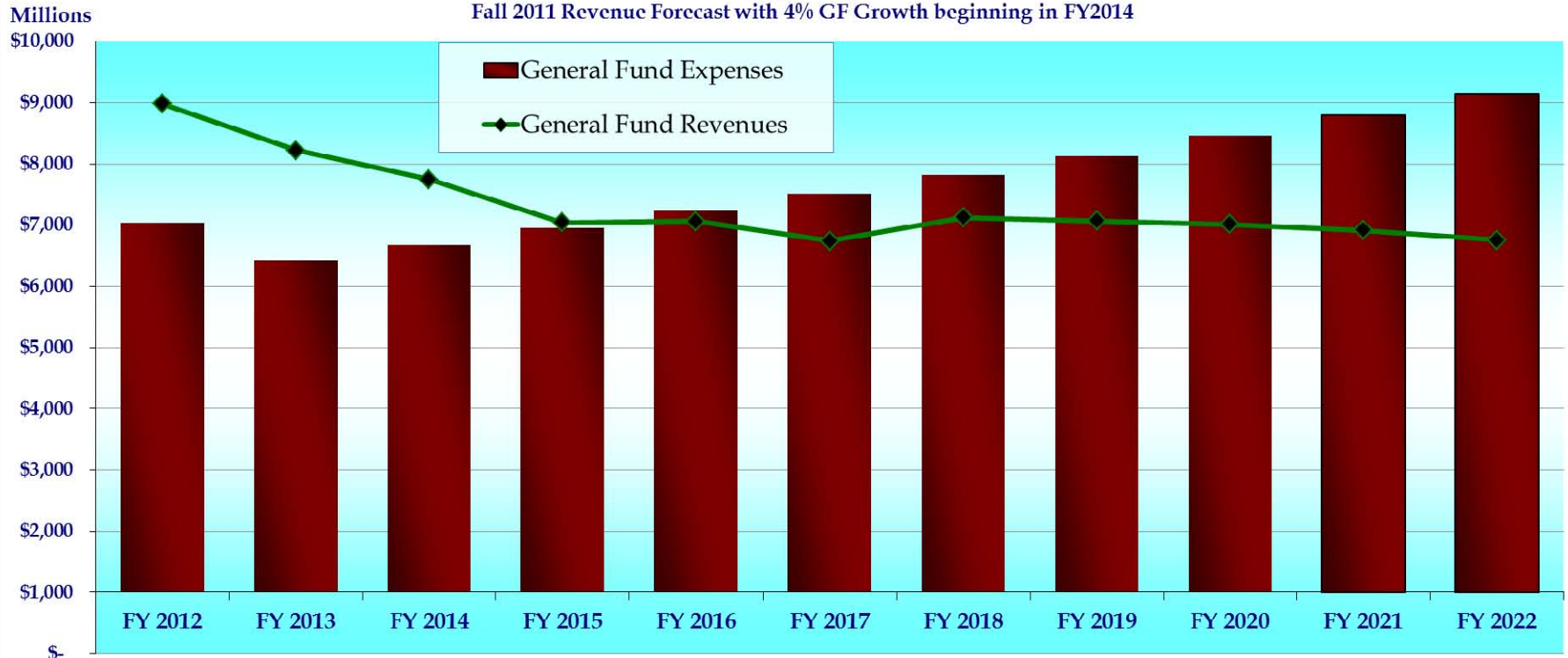
- Because that is what drives state revenues (royalty and taxes)
- And so, even if the *life* of TAPS extends longer into the future, the State will be in “dire deficit” long before that

Alaska's FY2013 10-Year Plan

(based on Governor's Budget and Forecast)

GF Revenue versus Appropriations FY12 to FY22

Fall 2011 Revenue Forecast with 4% GF Growth beginning in FY2014



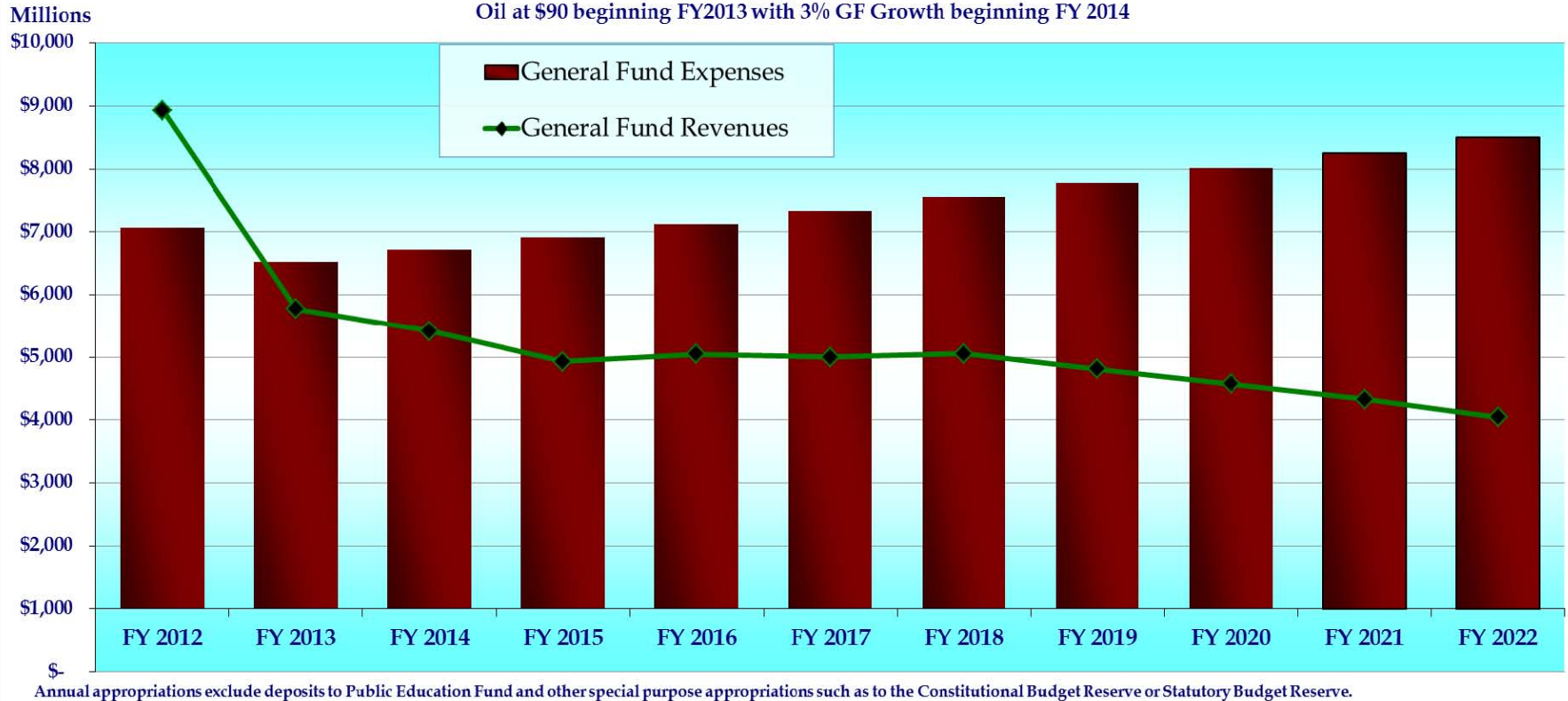
Annual appropriations exclude deposits to Public Education Fund and other special purpose appropriations such as to the Constitutional Budget Reserve or Statutory Budget Reserve.

Source: Office of Management and Budget FY2013 10-Year Plan (p. 14)

Alaska's FY2013 10-Year Plan (based on \$90 oil, rather than forecast)

GF Revenue versus Appropriations FY12 to FY22

Oil at \$90 beginning FY2013 with 3% GF Growth beginning FY 2014



Source: Office of Management and Budget FY2013 10-Year Plan (p. 12)

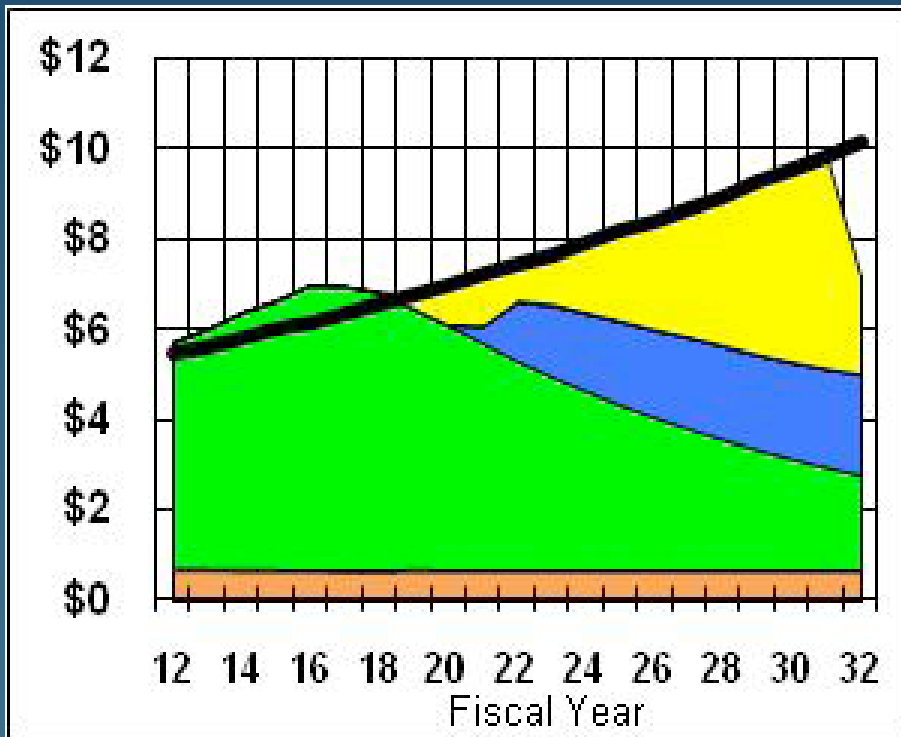
And the picture gets worse ...

- ... long, long before 2065
- The Administration's 10-year forecast only goes out to 2022
- Scott Goldsmith of UAA's Institute of Social and Economic Research (ISER) has extended last year's forecast on out another ten years ...

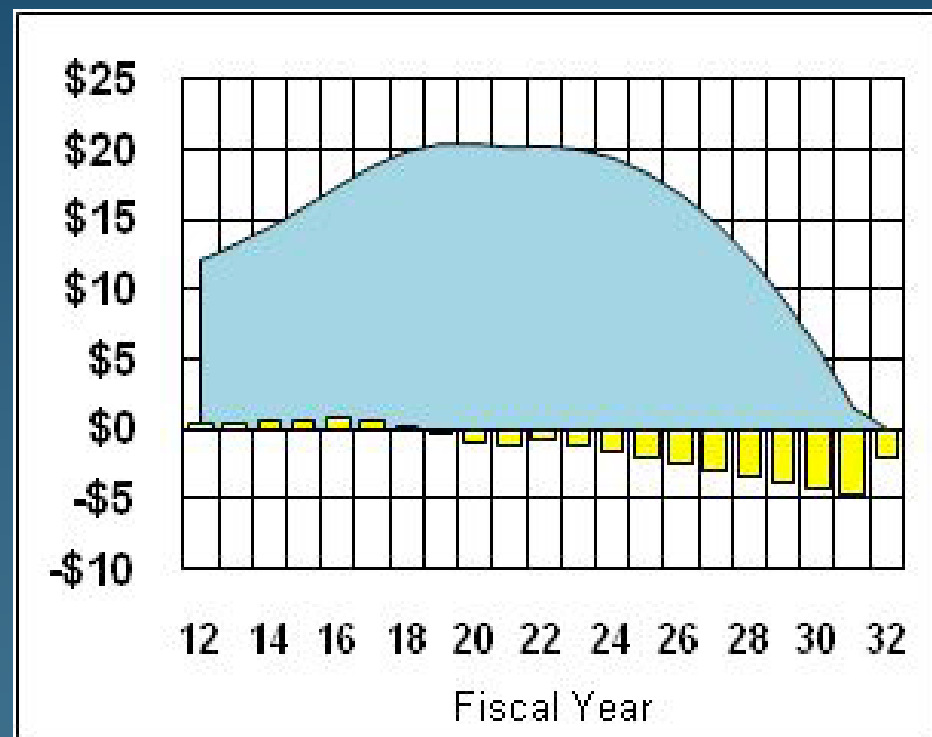
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, includes gas monetization)

GF Projection



Financial Reserve Balance

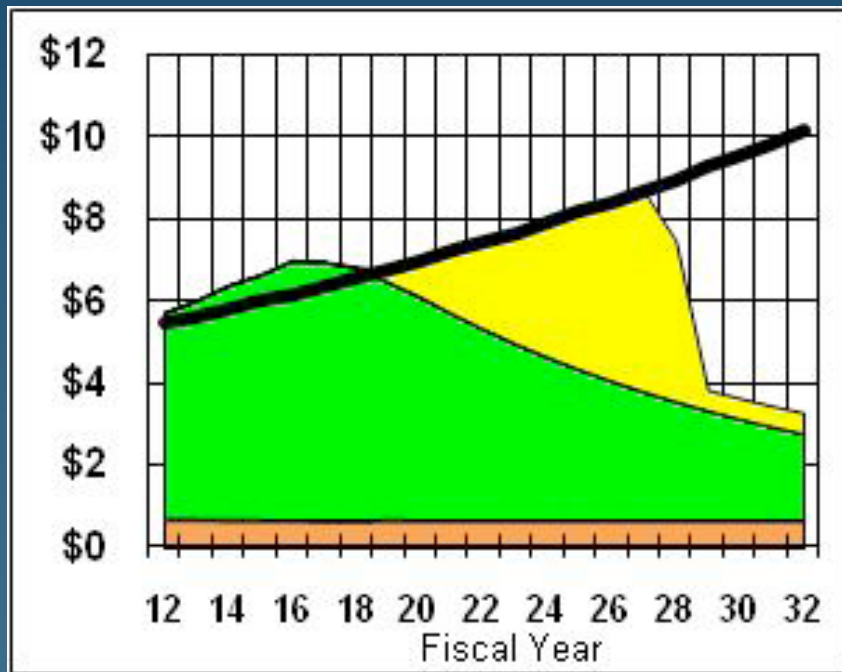


Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth, Web Note No. 9, Institute of Social and Economic Research University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)*

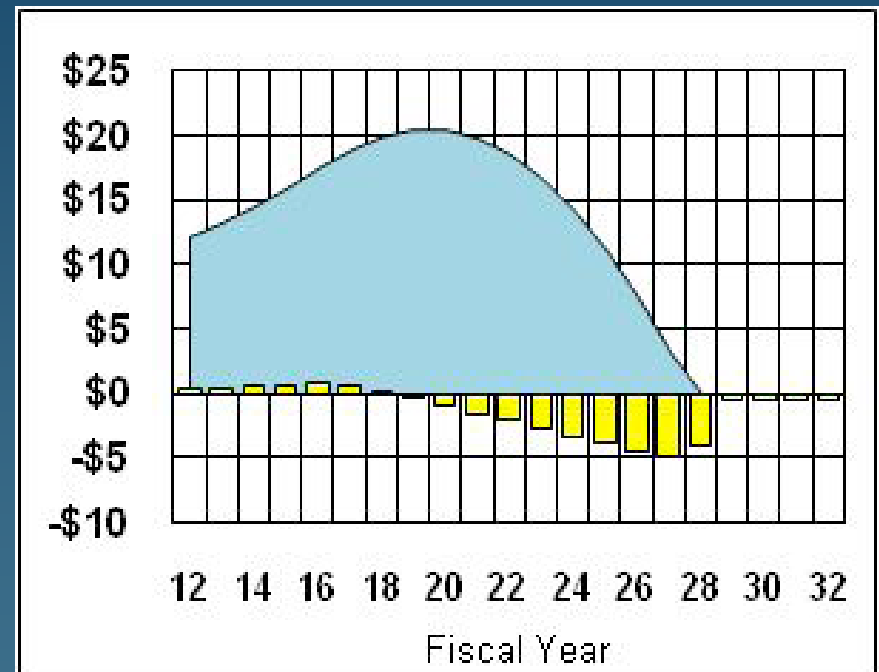
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, no gas)

GF Projection



Financial Reserve Balance

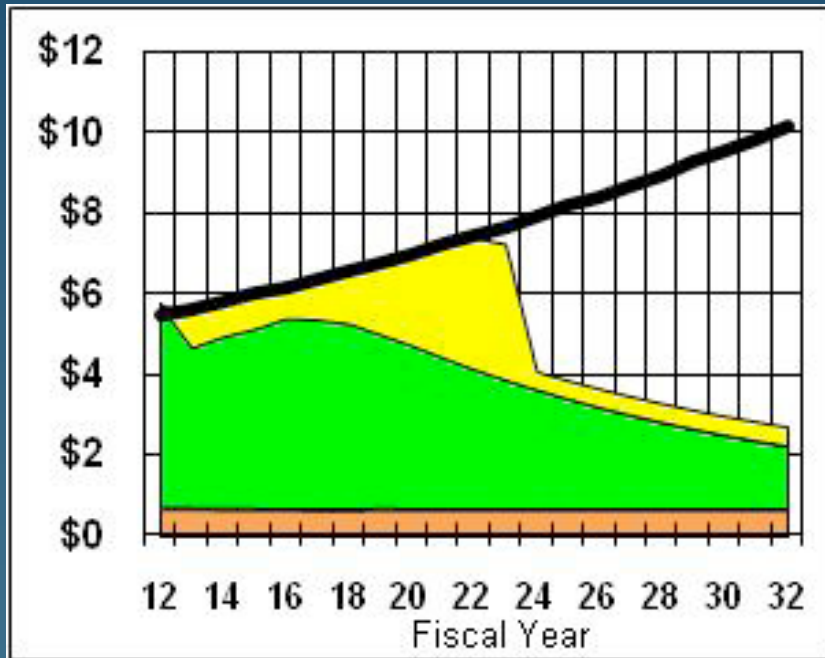


Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth, Web Note No. 9, Institute of Social and Economic Research University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)*

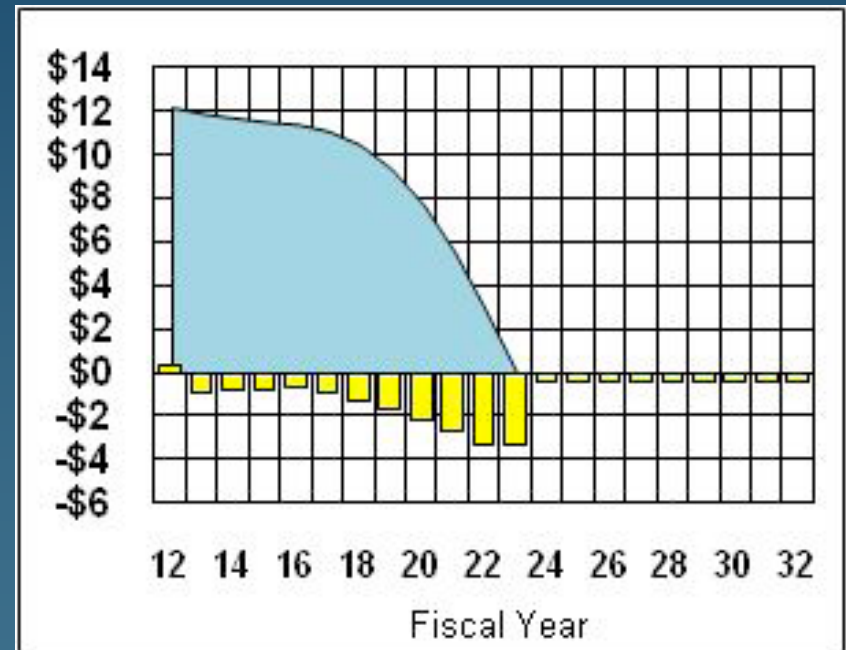
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, no gas/75% of oil price)

GF Projection



Financial Reserve Balance



Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth, Web Note No. 9, Institute of Social and Economic Research University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)*

Other Consequences of the Decision

- Increases TAPS rates
 - Roughly 25% of current TAPS rates are to recover ad valorem taxes; increased taxes, increased rates
- Decision disproportionately benefits NSB, Fairbanks and Valdez; hurts State
 - Increased TAPS rates reduce royalty and production taxes
- Significant additional tax hike on industry
 - Reinforces perception of unpredictable and litigious Alaska business environment

Conclusion

- Decision ...
 - ... does not “show bright future for Alaskans”
 - ... should not “ease the minds of Alaskans”
 - ... should not “give supporters of keeping oil taxes where they are new ammunition”
- In the end, “it’s the production rate, stupid” and the decision does not reach that