

Foster Natural Gas Report

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IT IS TAPS AGAIN: LAST TWO OWNERS OF TRANS-ALASKA SYSTEM FILE RATE INCREASES THAT TRIGGER PROTESTS AND REQUESTS FOR CONSOLIDATION

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The State of Alaska recently protested the rate filed with FERC by **Koch** Alaska Pipeline Co., LLC (**Koch**) (No. IS10-54), proposed to become effective 1/1/10, for the transportation of petroleum on the Trans-Alaska Pipeline System (TAPS) on the grounds that the rate: (1) impermissibly includes imprudent and unlawful expenditures relating to the Strategic Reconfiguration Program (SRP); (2) may impermissibly include costs relating to the dismantling and removal of TAPS facilities from the right-of-way; (3) assumes a life of the line that is significantly shorter than the actual life of the line; (4) uses an improperly-composed proxy group that artificially inflates the rate of return on equity, (5) fails to adjust the equity return to account for differences in the tax treatment of distributions to Master Limited Partnership (MLP) unit-holders versus corporate dividends, (6) fails to adjust the equity return to account for "anomalous and aberrant" capital market conditions; (7) improperly calculates the capital structure for the oil pipeline proxy group by excluding the current portion of long-term debt from the computation of long-term debt; and (8) may not accurately calculate appropriate operating costs and test period adjustments to those costs.

Anadarko Petroleum Corp. filed a separate protest, motion to intervene, and motion for consolidation, concerning **Koch's** rate proposal. Its filing was particularly directed to **Koch's** petition for partial waiver of certain rate filing regulations, which was appended to the 11/25/09 tariff filing.

Koch is one of five joint owners of TAPS, referred to as the "TAPS Carriers" or "Carriers." **Koch** proposes to substantially increase the rate for interstate shipments on **Koch's** share of TAPS capacity from \$3.45 per barrel to \$4.08 per barrel.

And yet another target of protests from the State of Alaska and Anadarko is the contemporaneous November 25 filing of Unocal Pipeline Co. (IS10-52, OR10-3) to change the rate for transportation of petroleum between Prudhoe Bay, Alaska, and Valdez Marine Terminal, Alaska, over Unocal's capacity share of TAPS, effective on 1/1/10. In its rate petition, Unocal, as **Koch** did, requested a partial waiver of the Commission's regulations to allow it to change the rate for transportation on its TAPS capacity using the same cost, revenue and throughput data utilized in recent tariff filings made by other TAPS Carriers. Unocal, like **Koch**, has not treated pre-2005 property balances as funded by 100% equity for purposes of computing deferred return, resulting in a rate that is 2 cents less than the other filed rates. In its filing submitted on the same day as Unocal's filing, **Koch** proposes the same rate as Unocal.

Koch (Alaska). **Koch's** 2010 tariff uses a test period net rate base of \$1,106,500,000, an amount that is nearly double the rate base underlying the 2006 rate accepted by

FERC Opinion No. 502, which was \$576,860,000. By using calendar year 2008 as the base period, **Koch's** test period rate base is also significantly higher than the 2007 average rate base of \$716,022,000 and the 2008 average rate base of \$889,945,000. According to Anadarko, **Koch's** proposed rate base is less than the \$1,122,700,000 rate base proposed by BP and the \$1,121,400,000 rate base proposed by ConocoPhillips and ExxonMobil for the same test period. This difference appears, to the independent producer, to be driven by **Koch's** explanation that the cost-of-service information "does not treat pre-2005 property balances as 100% equity in computing deferred return."

Alaska moved that the Commission investigate **Koch's** tariff, suspend it, and impose a refund condition once it is effective. In addition, Alaska moved that the Commission consolidate this case with pending consolidated rate cases filed on similar financial data by other TAPS Carriers in BP Pipelines (Alaska) Inc. (IS09-348), ConocoPhillips Transportation Alaska, Inc. (IS09-384), ExxonMobil Pipeline Co. (IS09-391), BP Pipelines (Alaska) Inc. (IS09-395) and ExxonMobil Pipeline Co., (IS09-177).

The State of Alaska already has protested the compliance filings of TAPS owners purportedly calculating the 2007 and 2008 rates in conformity with the ratemaking methodology established in Opinion 502 on numerous grounds. The State stresses that nothing in this protest is intended to waive, compromise, or withdraw any issues raised in the State's petition for judicial review or its protests of the compliance filings.

In this case as in the others, Alaska seems particularly irked by the substantial expenditures related to the Strategic Reconfiguration (SR) Program. The SR Program is a major construction project that the TAPS Carriers have said is intended to minimize oil transportation costs and extend the economic life of TAPS. Without discovery, Alaska insists it cannot determine the exact amount of SR Program expenditures included in calculating the rates contained in **Koch's** filing, but it estimates the proposed rate may include a combined total of up to \$500 million or more in operating expenses and capital costs. These costs would principally be classified as "additions to carrier property."

According to the State, the SR Program was "planned poorly and executed worse." Recent estimates indicate that the SR Program will cost more than three times the original estimate and will take more than five years longer to complete than originally planned. "Once a showing of inefficiency or improvidence is made, then the TAPS Carriers have the burden of dispelling the serious doubts as to the prudence of any expenditure raised by a complaining party and proving the questioned expenditure to have been prudent." Demonstrations of flawed decision-making processes are sufficient to create a "serious doubt" to warrant further inquiry into the prudence of incurred costs, Alaska noted in its protest. And the State of Alaska is already persuaded that the expenditures related to the SR Program that **Koch** appears to have included in its tariff were imprudently incurred and should be removed from the calculation of its rate.

Generally, Alaska repeated its prior contention that the TAPS Carriers approved the SR Program without an adequate design, adopted an unrealistic contingency for planning and evaluation purposes, and gave insufficient consideration to regulatory requirements. "The TAPS Carriers now seek to pass the costs of this poorly planned and badly executed project onto the State of Alaska and interstate ratepayers."

Among the other issues raised by the State with respect to **Koch**, it protests **Koch's** filed tariff rate also because it is based on an underestimated life of the line. The Commission should set the life-of-line issue for hearing so that the going-forward 2009 **Koch** rate will be based on current evidence, including reserve studies and SR Program impacts, all of which bear upon the remaining economic life of TAPS. (Note: The State's remarks on this issue obviously preceded the FERC order last Friday in which the Commission granted rehearing requests in other pending TAPS proceedings, and allowed this issue to be set for hearing, FNGR No. 2775, pp27-29.)

Anadarko, in turn, zeroed in on the request for partial waivers to allow Koch to change the rates for transportation of its share of capacity on TAPS using base period and test period adjustments and cost, revenue, and throughput data that are consistent with data reflected in recent tariff filings made by ConocoPhillips, ExxonMobil, and BP in Docket Nos. IS09-348, et al. According to Anadarko, this simple request would enable Koch to use an earlier test period with older data than normally would be required by the regulations.

Anadarko does not oppose a uniform rate for TAPS or the administrative convenience and efficiency of commencing from a common base period and test period for the Carriers' various rate filings submitted at different times during 2009. However, the Commission should clarify that any waiver for purposes of administrative convenience does not prejudice the right of participants to make any arguments that bear on the justness and reasonableness of the proposed rate. Anadarko "does not believe that Koch's waiver request or the June 30 order's grant of a similar waiver for BP preclude such arguments."

The rest of Anadarko's protest discussed the more typical rate case issues that were also a part of the State of Alaska's concerns. It similarly requested a consolidation with the proceedings in Docket Nos. IS09-348, et al., which involve the going-forward TAPS rates for three of the five carriers, BP, ConocoPhillips, and ExxonMobil. That also would now include Unocal's proceeding as well.

Anadarko blasted the SR program also, as the state did. According to Anadarko, the exorbitant amounts spent on SR have yet to provide any net benefit to ratepayers. Instead, as new pump stations are being placed in service and the related capital costs added to rate base, the Carriers' operation and maintenance costs are substantially increasing rather than decreasing as promised. According to Anadarko, ratepayers are getting hit with a "double whammy" of overlapping and duplicative costs; the scalable design of the SR project may be beneficial to the Carriers' owners and production affiliates but the current ratepayer benefit is speculative; and the lack of ratepayer benefit, the massive cost overruns, and the SR management issues, all raise serious doubt as to the prudence of the costs.

Unocal (Alaska). In its recent answer to similar objections raised to its filing by Anadarko, Unocal noted that the State and Anadarko protests raise precisely the same issues here that they raised with respect to the similar 2009 rate filings by the other TAPS Carriers (as well as in response to the TAPS Carriers' 2008 compliance filing). All of these substantive issues will be resolved in the 2009 proceedings, stated Unocal. "Assuming Unocal's filing is consolidated with those cases - as all parties agree it should be - that resolution will encompass UPC's filing." For one thing, the Commission's December 10 order has made clear that the life of the line is now included for resolution in the 2009 proceedings. Unocal, of course, continues to maintain that 2034 remains the appropriate TAPS end-life for use in rate-setting here.

As for the SR Program, Unocal conceded that certain unexpected issues inevitably arose as the project developed, and certain resulting adjustments in planning and execution were required. The fact that adjustments were made, however, does not mean that any associated costs were imprudent. And, among other things, when reviewing the method for establishing rate of return, Unocal cautioned, "the Commission should reject as unreasonable any suggestion the DCF model is fine when it results in low returns but must be adjusted if the model results are seen as too high."

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