

ALASKA LEGISLATURE
JOINT COMMITTEE ON NATURAL GAS PIPELINES
August 19, 2002
10:15 a.m.

SENATE MEMBERS PRESENT

Senator John Torgerson, Chair
Senator Johnny Ellis
Senator Pete Kelly
Senator Don Olson (Alternate)

SENATE MEMBERS ABSENT

Senator Rick Halford

HOUSE MEMBERS PRESENT

Representative Hugh Fate
Representative John Davies
Representative Reggie Joule (Alternate)
Representative Joe Green (Alternate)

HOUSE MEMBERS ABSENT

Representative Brian Porter
Representative Scott Ogan

COMMITTEE CALENDAR

Committee recommendations to the 23rd Legislature
Energy Policy Act of 2002

WITNESS REGISTER

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City of Valdez, Port Authority
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ACTION NARRATIVE
TAPE 02-7, SIDE A

CHAIRMAN JOHN TORGERSON called the Joint Natural Gas Pipelines Committee meeting to order at 10:15 a.m. and announced that Patrick Coughlin, consultant to the Senate Resources Committee, would testify first.

MR. PATRICK COUGHLIN, consultant to the Senate Resources Committee, said he would provide the committee with a brief overview of how the federal energy legislation came to be, what's in the bill and then focus on the bill's provisions relating to an Alaska natural gas pipeline. He began:

Shortly after assuming office, President Bush established a National Energy Policy Group to develop a national energy policy. That group was headed by Vice President Cheney and they put out a report. That report contained numerous recommendations regarding national energy

ranging from electricity deregulation to capping standards, but it did contain some focus on increasing gas supplies and this was especially true given, of course, what we all know is the runup in gas prices in the winter of '00 and '01. The report noted that 'the most significant long term challenge relating to natural gas is whether adequate supplies can be provided to meet supply which is sharply projected to increase over the next 20 years.'

To meet this problem, the Bush Administration recommended that we look at ways to expedite construction of a gas line from Alaska and it recommended that the President direct the agencies to work with various interested parties including Canada and the State of Alaska and it's recommended that Congress look at changes to ANGTA, which was the existing law providing for the construction of a pipeline from Alaska. Following the report, the House of Representatives took up an energy policy bill and they passed that August of last year. Then the Senate took up the bill and that bill is referred to as HR 4 and as this committee knows, that process took place in the fall of last year and ultimately led to the passage of the Senate version of the bill in the April/May timeframe of this year.

Both houses have passed two distinct versions of the energy bill. It's the first attempt by the U.S. Congress to pass a comprehensive energy bill in the last 10 years and there are substantial differences between the two bills and, just by way of background for members of the committee, I included in your packet a table, which was prepared by staff for the Congress listing the major provisions of the bills and the differences. As you can see, there's provisions relating to electricity restructuring and we're all familiar with ANWR and the differences between the Senate and House version. The average fuel economy standards are there; there's many differences between taxation policy and incentives in the two bills and the list goes on and on. As a result there has been a conference committee appointed. That was done this summer and Representative Tauzin is the chair of that committee and Senator Murkowski and Representative Young from Alaska are members of that committee also. During the summer the committee has done work and tried to identify issues, which are major discrepancies between the House and the Senate version and ones that they have similarity on. Our best information is that they expect

to get back together in September and first take up provisions that there may not be any significant disagreement between the two bodies and then later take up the other more difficult provisions.

With that background I wanted to focus on the provisions in the bills related to the Alaska Natural Gas Pipeline. Both versions, that is the House and Senate versions, both contain a provision relating to route selection, which is they both preclude the over-the-top route and, in fact, that is basically the only provision in the House version of the bill that really deals with the issue. The Senate version provides an alternative framework to ANGTA that allows for the expedited construction and operation of a natural gas pipeline from Alaska. That bill also reaffirms ANGTA and allows the ANGTA system to be modernized. Significantly, there are two financial incentives contained in the Senate version of the bill for the Alaska pipeline. One authorizes the Department of Energy to provide loan guarantees to the project up to the amount of \$10 billion. The second one provides a tax credit at an inflation adjusted price that is, if the gas goes below this price, the seller of the gas will get a credit to the extent that the price of gas is below \$3.25 at a place referred to as the AECO Hub, which is in Alberta, Canada. It is this later incentive that has caused the stir in Washington D.C. and in Canada.

MR. COUGHLIN said he prepared a side-by-side comparison, which simply shows what the House has done with the Senate version of the bill with respect to the Alaska natural gas pipeline (in members' packets). He also noted where, in the Senate version of the bill, the proposals adopted by the committee last fall are located. He explained that HJR 44 said the Alaska Legislature supported the bill that was pending in the Senate as long as certain conditions were met. Those conditions were:

- A ban on the over-the-top route (in the Senate bill).
- Provisions for access to gas for Alaskans and for a role for the state in setting the tariffs (in the Senate bill).
- A fair and open process to allow explorer groups (oil and gas companies without an ownership interest in the pipeline) to have access to space in the line and the ability to expand the pipeline in the future (in the Senate bill). He said there were provisions for the establishment of procedures by FERC for an open season, a new condition that the Alaska

Legislature asked for. It also allows an explorer or the State of Alaska to seek expansion if they believe it is justified, another unique provision.

- That Congress affirm ANGTA to assure that just because an alternative framework in which someone could get a certificate to build a pipeline could be created does not mean that ANGTA would be done away with, but that it could also be modernized (in the Senate bill).
- Tax credit incentives (in the Senate bill). He explained that the tax credit is given if prices go below \$3.25 and the bill contains a repayment provision if prices go above \$4.87. It does not have accelerated depreciation, but it does contain a loan guarantee provision.
- No exclusion for gas-to-liquids or for LNG. There are no provisions that prohibit that from happening, but it's fair to say that there is no support for it. It maintains Yukon Pacific's permit status, because as part of reaffirming ANGTA, it said previous decisions under ANGTA are still valid.

MR. COUGHLIN said another provision in the Senate bill that was not in HJR 44, but was put forth in the committee's proposals last October, was that Congress provide for a project labor agreement. The Senate version of the bill does not mandate a project labor agreement, but says it's the sense of the Senate that the project sponsors are encouraged to enter into a project labor agreement.

The committee also asked that Congress provide for Alaska hire and Alaska contracting. The bill has no provisions mandating that, but it does contain a \$20 million grant for the Department of Labor to conduct a study of training programs that could be provided in Alaska to train Alaskans to get pipeline related jobs. Once the study is completed, those training centers would be established within Alaska for that purpose.

MR. COUGHLIN said the bill provides an alternative framework to ANGTA for an expedited process to have a pipeline completed quickly. For example, it requires FERC to expedite consideration of issuing a certificate if an application is filed and it sets expedited timeframes under which the EIS process is to be completed. It also designates a lead agency in the federal government so that there's no dispute among the agencies about who is going to be in charge of preparing the EIS and it provides for a federal coordinator to oversee the whole process and to make sure that any disagreements between the agencies get resolved promptly. Last, it provides for a limited judicial review and expedited court consideration if there is a lawsuit.

CHAIRMAN TORGERSON asked Mr. Coughlin if, in his opinion, the provisions in the Senate version reflect the will of the Legislature that was laid out in HJR 44.

MR. COUGHLIN answered they do and added:

There are many parties to this proceeding and I wouldn't say word for word that the Alaska Legislature got 100% what we wanted, but in general, there are provisions that deal with and address every issue that the Alaska Legislature wanted in the bill.

REPRESENTATIVE GREEN said there has been some objection to the incentives and asked Mr. Coughlin if he thought they would remain.

MR. COUGHLIN replied that he wasn't enough of an insider to give a fair answer to that question. He pointed out:

They're on the table and I can only tell you what I've read in the press and that is, if the bill passes, and I think people think there's a likely chance that it will pass, there will be some kind of incentives - whether they will be exactly the same I can't say.

CHAIRMAN TORGERSON said that is what he has been hearing also. "It has some problems, but it appears they have the votes for it to go."

SENATOR OLSON said the Senate version of the bill contains \$20 million to train people throughout Alaska. He asked why the House version does not contain a similar provision.

MR. COUGHLIN replied that the only provision the House included was the ban on the over-the-top route. He thought that was due to a timing issue because the producers put forward their proposal for this alternative framework in the summer of last year. By then the House was pretty far along in the process.

SENATOR OLSON asked if the ban on the over-the-top route was going to remain.

MR. COUGHLIN replied that he has heard that it's not a "conferencable" item, because the same provision appears in both versions. He noted, "If a bill passes, it will be in the bill."

SENATOR OLSON asked if he was expecting any amendments to reverse

that.

MR. COUGHLIN replied that he is being told that can't be done.

CHAIRMAN TORGERSON said he understands that provision could be changed, however Chairman Tauzin did not put that on his list of things that were accomplishable.

He said a gentleman's agreement was made between everyone involved that amendments wouldn't be offered. He thought opening up the bill to amendments would kill the bill because nobody got exactly what they wanted. He surmised, "But overall it's not a bad bill."

REPRESENTATIVE FATE asked about the labor contract agreement that is in the Senate bill.

MR. COUGHLIN replied that there is a provision in the Senate version of the bill that deals with two subjects: the use of U.S. steel and a project labor agreement. He explained:

It basically encourages the project sponsor to use U.S. steel to the extent that they can [and] to try to negotiate project labor agreements to expeditiously construct the project.

CHAIRMAN TORGERSON noted that is a non-binding agreement.

MR. COUGHLIN agreed that it's not mandatory.

CHAIRMAN TORGERSON asked if there were any more questions of Mr. Coughlin and there were none. He noted that he had given the committee a report (paid for by Phillips Petroleum) by Charles River and Associates that talks about other incentives, the impact on consumers and answers a lot of questions. He also included a paper called "The Joint Committee on Taxation Report" dated May 23. He hadn't received a copy of the OMB report yet.

MR. MARK MYERS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), said he was here today to represent the Administration. He stated:

I want to, for the Administration, thank the committee for the work they have done. You have taken on a very complex issue of great importance to the state and I believe you have turned over a lot of rock and looked at a lot of hard issues and have gotten a good grasp of the complexities and issues involving the pipeline including how the open season process works, how access works, etc.

So, I just personally and for the Administration want to thank you guys for a job well done in your analysis and also thank you for the input that you have provided to the congressional delegation in D.C. and I'd just like to personally urge you to continue on in the good work.

Here today, you've asked a series of questions to me and I think if I could just address those questions and get through them rather quickly and then be here for questions. The first question the committee wanted thoughts on - whether the credit provisions in Section 25.03 would be beneficial or harmful to construction and operation of an Alaska gas line - that basically refers to the tax credit mechanism that Patrick has talked about. I think to break that question down, basically to look at it in terms of beneficial to Alaskans and then to the North American market, in general and then also to other producers would be the appropriate way to look at the question.

First of all, I think if you look at the pipeline project itself and you want to look at risks to the project, the primary risk to the project isn't the fact that gas is there. It isn't the technology needed to bring it to market, it isn't the demand in the markets, it's fundamentally a prices issue if you look at risk and commodity price on the low end. It's a lot of capital to invest; it's a lot of modifications to production of oil on the North Slope and it's a lot of effect on future exploration based on having this line present and having certain baseline economics. So, if you strip away everything else, I think an objective person would say that that tax credit gets to the core risk involved with the project. That is if you would have periods of low prices. I think no one expects the price to maintain levels of less than \$3 or so an MCF, but it certainly is possible given the volatility of the market that there are short periods of time, in which case the price could drop down below threshold markets.

My experience with economists predicting prices, forecasting, it's more art than science and there's certainly risk - in the predicting on a short-term period for several months of commodity price. So, this floor stabilizes that. As mentioned, it's been scored as revenue neutral. So, I think this particular provision is extremely valuable in that it takes a lot of the risk out of the project and it sort of - with the floor - then

would guarantee if you calculate everything else giving you a guaranteed base level of rate of return that you could always count on for the project, again, huge if you're investing capital, huge if you're exploring for new resources for gas in the future - so, I think it's clearly going to be beneficial for the project itself. And the project, I think, of course, is beneficial to Alaskans... producers and the explorers, as well, and also for a pipeline company - obviously, the less risk in the project in terms of the pipeline consortium if they are building it. So, a tremendous mechanism in alleviating risk - again scored as neutral - so, a lot of value there.

Now, whether it's beneficial to the consumer in the Lower 48 was one of the other questions. If you look at that, I think you really have to look at the gas market in the Lower 48 and in North America in general and then that determines having to calculate out what you think the supply deliverability will be in the future as well as the demand. So, you have to look at both those elements and I think one of the encouraging things for the Alaska project is in fact the projected growth. Everyone projects growth in the market beyond existing capacity. The EIA numbers show by 2020 an additional 7 - 11 TCF of gas needed. There are studies that show slightly less and some that show more, but, in general, a very significant increase in demand in gas and I don't think anyone is disputing that. And the long-term perspective is independent of the short-term recession that we might be under.

The second - that is more dear to my heart because I'm an explorationist and I look at supply issues in particular. If you look at deliverability of gas in the system, the supply available, I think there are serious questions. And if you look at it from more of a geological perspective, you reach much higher levels of concern than you might from strictly an economic perspective. Kind of two facts to support that is between 1990, typical wells put on line had about 40 months of production before they started to decline - gas wells. In 1999 it was down to 24 months. So we're seeing about a 50% increase in decline rate. That typically over a large scale looking at multiple basins is an indication that your supply is not as robust - that you're finding and developing smaller gas accumulations. So, that's one thing in the long-term supply, even with the increased amount of drilling that

we're seeing, we're not seeing sustained long-term success rates. We're seeing gas delivered, but again, less bang for the buck, less return for each well being drilled.

The next, and more specifically focusing in on the market that this would compete against in Alberta, look [at] the western Canadian sedimentary basin. We're seeing almost every party's projections showing between 2010 and 2015 a decline in the availability of gas and deliverability in the basin. That basin is a very mature sedimentary basin for the production of conventional gas and that gas is in decline. They expect an increase in completions from 3,000 - 5,000 per year, yet expect the basin to decline. So, again, if your supply side is declining and your demand is increasing, it's going to be a lot of work to keep that supply level stable.

And then there's incremental amount of demand there. That would indicate a potential shortage for the customers, particularly in the Midwest where this gas line would be tending to go. So, again, from the consumer standpoint, I think there's extreme value in North America and in the United States in particular. So we have a long term guaranteed supply that will not make up for the existing supply, but compete in the market for that new expansion capacity, which will be needed. So, I think again the tax credit, if it gets this project built, has tremendous potential.

Another really positive element is Alaska's gas potential beyond the known 35 TCF on the North Slope. We've seen a recent USGS report that says technically recoverable gas - as much as 59.7 TCF of gas in their mean case in the NPRA, alone. Then we have state lands of equivalent geology just to the east of there. We have the known gas hydrates on the Slope, which again, exceed the known discovered conventional gas. So, we're looking at a tremendous amount of gas that could provide a long term deliverability to the United States for a 50-year plus period of time at 4.5 - 6 BCF/D. So, again, long-term stability and supply for the United States could be achieved by this gas line so it's clearly in the nation's interest. So, again, I think from the Administration's standpoint, we see the tax credit as very valuable.

MR. MYERS said that a letter from the Governor to the conference committee dated May addressed several issues, one of which was the

importance of the tax credit. He explained:

The other question is how it would affect other existing gas producers. Certainly, you can't argue that it would have some market effect. Realistically, the success of the project one way or the other will affect the markets there in Alberta and will affect deliverability in Chicago. Again, with the supply and demand situation, we expect that not to be a competitive thing, but basically that multiple progress can go, that Canadian coal bed methane projects will need to go, that this project does not threaten the Mackenzie Delta area and its upside potential and it's deliverability of gas. So, I think we're in a situation from a supplier side that's enviable in that there's enough demand or will be enough demand in the market that the Alaska gas should not threaten Canadian production. Therefore the floor should not be a terrible threat to other producers and you may hear differently today.

REPRESENTATIVE DAVIES said he thought the Bush Administration was on record supporting this.

MR. MYERS said he meant the Knowles Administration.

SENATOR OLSON said he had an optimistic point of view.

MR. MYERS replied:

If you look at the economics they [the producers] have presented based on the three price in Chicago, and you look at what an equivalent netback would be with a minimum \$3.25 floor, you can calculate your own rate of return and I'll let them do it, but it will be a very positive rate of return. In addition, it does one other thing. When companies need a higher rate of return, it's usually associated with the risk of the project. So, if you've eliminated or minimized the commodity risk, one would believe that a project would have better economics at a given rate of return if the risk is lower in terms of lower financing costs, in terms of risk to the shareholders. So, again, I think the floor is a very positive mechanism. It does multiple things. It eliminates risks and I think it actually - depending on - to know what their projected rate of return for the project will be, you will have to know what their costs are, which we really don't. We have a kind of a general idea, but very crude and you would also have to know what

their internal price projections are, which you can ask them to share if you want, but they generally don't share that information with us. So, this is being discussed with public numbers and the earlier calculations were done at a lower value price than this would provide at a base level. So, again, very positive I think...

SENATOR OLSON asked him to expand on the perspective that if the trillion cubic feet of gas that's coming out of our area is developed, it will not affect or negatively impact the supply coming off the Mackenzie Delta in any way.

MR. MYERS responded:

The way I would come to that conclusion is not that individual projects don't compete. Obviously, every oil field competes against every other, every company competes, it's a healthy competition. The question is does it really impede the development. And to that I think you have to look at supply and demand issues. Again, if there is a net increase in supply of 11 TCF and you're doubtful whether you can maintain production at existing levels and [I] think it's very doubtful that Canada can, in fact, unless offshore really produces or unless coal bed methane just goes hog wild, which will require higher sustained prices. So, under most likely producing scenarios, the demand would be there in Canada to use that gas for Mackenzie and, depending on timing, it might compete for the sum of the pipeline capacity.

But, on the flip side, as Canada produces more and more of its heavy oil reserves, they are requiring more and more gas to get that heavy oil out of the ground. They intend on using their gas and have incremental oil supplies similar to what we've already done on the North Slope by our gas cycling and our tertiary water recovery mechanisms. So, if you look at the demand, it can eat up 1 TCF of gas from Mackenzie without much problem and still have plenty of room in the market for the 4.5 - 6 TCF of gas coming off the North Slope. You have to look at will there be short-term. If you bring all that supply on at one time incrementally, it might have some short-term effects. And that's delayed by how long and how well a market can absorb that, but I think most people think the market will absorb it relatively quickly because of the interconnectability of the Hub system of pipelines. That gas can be distributed over a large number of markets, but that's something again the committee might

want to look at in terms of the details of the forecasting mechanism.

CHAIRMAN TORGERSON asked if he had seen the producers' model in terms of their netback.

MR. MYERS replied that he hadn't.

REPRESENTATIVE GREEN said that the risk has been downplayed because of the floor and they are now hearing that the cost continues to climb much faster than inflation. He asked if his models use the original costs inflated at a reasonable rate or whether they use higher inflated costs.

MR. MYERS replied that they hadn't costed-out the pipeline independently. They aren't really able to, because they don't know the exact details of the project, the size of the pipe or pipes, the gas treatment plan, etc. He surmised, "There's clearly a whole lot of data out there that we don't have access to and so you just have to somewhat look at their values... to see if they are realistic."

He said one of the positive things from the state's perspective is that the over-the-top route costs are now nearly equal to that of the highway route. For the overall costs, there is a tremendous amount of variance in the B to C route from Alberta to Chicago and the amount of additional capacity that will add to the existing capacity. The answer lies in the amount of available capacity at the time Alaska gas is about to enter the market. The state doesn't have a firm idea about it because it doesn't control the timing of when the gas line would start.

MR. MYERS said question number 2 was whether DNR supports the open season provision, Section 704(e), and whether it supports the pipeline expansion provision, Section 706(a)-(e). He clarified:

Basically, 704(e) puts in the ability to expand the pipeline for non Point Thompson and Prudhoe Bay gas. So, in other words, it actually puts under certain conditions, which protect the economic rights of the pipeliners and the other producers: can you have a mandatory expansion of the line?

The Administration - again, and the access issue - if you go back to the letter in May - clearly the Governor thought it was very important that that provision be in there. I think the provision we have is a compromise provision that is acceptable to the producers, the

explorers, the pipeline and the state. So, it's a balanced proposal. As it is we strongly support it. The need for it became relatively apparent us in that we want to see expansion of exploration outside the existing areas. Along that line, I will give the Governor a fair amount of credit on the fact that we got the line south of the 64-degree latitude. And again, I know it was an exclusive concern and this committee was concerned with the same issues, but one of the issues - there was other gas than just the barrel arch on the North Slope, not the foothills, but the Yukon flats, the Nenana, the Kangik that some of these other basins to almost south of Fairbanks had a potential to get gas into that line under the credit mechanism. So, again we clearly recognize the need to expand for gas other than the North Slope. Prudhoe and Thompson gas was an absolute requirement by the state and so we clearly support that - those mechanisms. And again, if you look at the Governor's letter that follows through very clearly that the access, both in the lines of access for new, explored for, and discovered gas, but also the access to communities to get at that gas were priorities.

TAPE 02-07, SIDE B

[MR. MYERS' TESTIMONY ON QUESTION NUMBER 3 WAS NOT RECORDED.]

MR. MYERS said the Administration clearly supports the Alaska royalty gas provisions in Sections 704(g) and (h) and 709(c), recognizing that they are a compromise. He explained:

The need to have the RCA look at in-state we think is a very good idea. It's consistent with the policy on oil lines and we think they provided a very valuable, more localized perspective and also for the RCA to have input to FERC is equally important. Again, we value having an independent, quasi-judiciary approach intrastate....

MR. MYERS said the fifth question about supporting other incentives in the Pipeline Act is related to the loan guarantee. DNR thinks that should lower financing costs, which should lower their overall number so whatever it is, is positive. The combination of events should make the pipeline much less risky. Anything that lowers the cost does multiple things. It lowers the risk of the project on the construction issues; it also potentially lowers the tariffs on the line, which is very valuable. As the royalty owner and for tax purposes, the state's netback for gas increases, so it has a vested interest, and consumers have a vested interest, in a lower tariff,

which will ultimately bring a lower price to the market. Those incentives are very positive since they add stability to the project and potentially lower the cost of tariffs.

CHAIRMAN TORGERSON asked if a document he showed Mr. Myers was a public document and how he got it.

MR. MYERS replied that it was public and that three major producers provided the state with information for a discussion on terms of clarity and certainty of the project. He told members:

Fundamentally, they had talked about the state needing to provide a clearer, better fiscal understanding of what the conditions and terms were for the pipeline. We had particularly asked them primarily what they meant by that - multiple times. We had a bit of frustration quite honestly trying to figure out what in the world that meant. This document, I think, is the first attempt to look at those issues and to answer that question for us. So I very much appreciated, and the Administration appreciated, the producers coming forward and saying these are the kinds of things we would look at to create that environment.

So, what the producers presented was basically a different way of valuing gas, a different way of taxing gas, a different way of looking at the royalty terms in terms of the lease form, basically a total overhaul of the current way we value gas on the North Slope or in other areas. So, this document suggests some very radical changes to our public policy. That is in a sense a power point presentation representing their view of the perfect regulatory environment.

CHAIRMAN TORGERSON asked what the Administration's next move will be with regard to the document.

MR. MYERS replied that the Administration would like to have further discussions with the producers on this point. He said it was clear that they would hold discussions, not negotiations, about fleshing out what they mean by the various terms. There are eight major royalty terms in there and probably an equal number of tax terms. The Administration wants some clarifying discussions. He thought it was a good faith effort by the producers to start the dialogue and the discussion. The issues are complicated and need to be looked at in terms of are they appropriate now or later or ever. He concluded:

So, again, from our perspective it's sort of a producer wish list of the things you would like to have. The state would, I think, not agree to many of those as things it would like to have... So, they would rely ultimately on negotiations if the new administration, whoever that be, and the legislature thought that was appropriate.

CHAIRMAN TORGERSON asked what inspired the producers to come forward now when they had been asking for this for a couple of years. He also asked whether the [Administration] is initiating any studies to work through the producers' list.

MR. MYERS said that part of the issue is fully understanding what the producers are asking for and what they mean so the state isn't confused. He continued:

...then the supporting data as to why certain incentives would be necessary. So I think the background data, and the studies, of course, we have some ongoing gasline studies. I think you'll see a CIP request to the legislature this next year to further on the issues and more attune with the issues. One of the issues, royalty valuation, are we going to get involved with trying to develop a market basket approach like we have for oil and when is it appropriate and how would you do it. So it's clear that if the legislature asked us to do that, we would definitely need outside resources and outside support to do that. So that's one issue - not understanding where the gas is going, how it's going to be valued. To do a mechanism now, you would have to look at a surrogate mechanism. You would have to hopefully know more about the project, but also know more about how gas would, in fact, be valued so we're making sure we're getting fair market value for the gas.

The same issue with tariff issues. A lot of issues affect the lease form. You know, do we want to do these things and what's the large impact in oil production on the North Slope? What's the effect of potential fallout from gas elsewhere like Cook Inlet. So you can develop from a list like that, a list with a lot more questions and we clearly would need external support if we did it in the negotiating stage on these. I guess the first thing is to start the dialogue and then the second thing is, if the new administration and the legislature deems it appropriate, that we enter negotiations, that we get the outside help that we need. Certainly, that discussion would not be limited to the Administration.

CHAIRMAN TORGERSON asked if the state needs a bill like the Stranded Gas Act to tell the Administration to start negotiating before you start negotiating.

MR. MYERS replied, "I'm on real thin ice here." He thought the dialogue should go on, but the challenge would be when you enter negotiations, which he thought would be more appropriate for the new administration since it would be unfair to start now.

CHAIRMAN TORGERSON said they are working on recommendations to the next legislature and asked if they should put in a timeline for negotiations to start on January 18 and finish on April 1.

MR. MYERS said he didn't think that was necessary. The list that the state negotiates has to be decided very clearly. Certain items, if you're looking at production in the 2008 - 2014 time range, there is time on many of the issues. The question is do you want to negotiate them now or wait until they have more data.

CHAIRMAN TORGERSON said they are waiting for Mr. Myer's report on potential reserves on the North Slope and asked where he was on that.

MR. MYERS replied that the division is frantically working on it and will try to get the committee something by the end of September. The report will not contain a lot of original work, but will be more of a synopsis. There are still a lot of questions in the foothills so there would be a very broad range of numbers. They hope to compile a report with some positive results as they have the new NPRA numbers and some preliminary USGS data from some of the interior basins.

CHAIRMAN TORGERSON said he intends to have one more meeting before this group disbands to finalize its recommendations to the next legislature. He thought that report might be good to have when dealing with the conference committee to show the potential reserve on the North Slope instead of being hypothetical. He asked what the division is doing in Cook Inlet for an upgrade reserve analysis.

MR. MYERS said the division has the demand study, but hasn't focused on any kind of new supply study. The division is trying to save the state a few dollars since the USGS is starting a major assessment of Cook Inlet.

REPRESENTATIVE DAVIES asked if he meant this is the perfect regulatory environment from the standpoint of the oil companies.

MR. MYERS replied that is correct. The oil companies might characterize it as a compromise position, but they presented the state with a wish list and it is clearly not to the state's maximum economic advantage.

REPRESENTATIVE GREEN said that prior to the startup of Prudhoe there was good cooperation between the operators and the state as far as subsurface geology, values, transmissibility, etc. and asked if he anticipated that same degree of cooperation in the future.

MR. MYERS replied that he is optimistic that will occur. Although there has been a period of time in which there hasn't even been alignment within Prudhoe Bay with various owners. They are almost there with the producers in terms of them "speaking off different sheets of music in terms of their technical interpretation and the effects." He added:

Until you have ultimately their commercial agreements in place and you have multiple issues between Pt. Thompson and Prudhoe, I think it's not going to be clear to us where their commercial positions are. As far as the exchange of technical data, we've had in the last eight months a couple of very very good meetings. We had initially a very slow start in terms of the effects of gas sales on Prudhoe and the mitigation measures that might be performed and the same with Pt. Thompson initial discussions. Those discussions have been much more fruitful as of recent. So, I'm optimistic there will be good dialogue and good discussion.

The alignment is helping somewhat. The alignment has pluses and minuses in terms of data, because when the parties weren't aligned, you'll hear multiple technical interpretations, which, again, they're all within the legitimate range of just variable. When you have a unified front, you'll get a single interpretation. So, that creates some challenge to the interpretation of basic data, but there seems to have been more willingness to share the effects of gas on oil production, which again, has been very useful. They have some very good models out there. They've done a lot of the work. It's not just us involved with the issue; it's the Alaska Oil and Gas Conservation Commission. We have a strong relationship with them. They are committed to doing this reservoir study on the effects of Prudhoe and following over to Pt. Thompson. I think that's a very important piece of work for the state to do to have their own independent assessment. The cost and scope of that study

will be largely dependent on the cooperation of the transference of data. So, again, I'd say that I'm cautiously optimistic...

REPRESENTATIVE GREEN asked if Mr. Myers was using a USGS-type of approach in that reserves on the Slope would be available and, assuming there's so many cubic miles of sediment, there's a probability and an upper and lower or would he be more specific.

MR. MYERS replied:

The honest assessment is there's a wide range. We looked at two approaches. Initially, we even went in for the supply side CIP for the North Slope and we asked for a lot more money than we've got and we scaled it back. We were going to do a USGS-type assessment where we ran the full risk values. We decided not to go that way. We didn't think at this point it gave a lot of value, particularly with the new data. We have folks shooting 3-D seismic in the Foothills; we have a lot of changes; we have a lot of new approaches in terms of the issues involving the reservoir rocks.

Fundamentally, on the foothills, the most difficult issue to get your arms around is the size and distribution economics of fields. We know the gas has been generated; we know the reservoir rocks are there, but they're relatively low quality - just how low quality is the real question. Is there enough porosity and permeability in the rocks for large sustainable fields? Are we looking at a cluster of 200 million barrel fields or are they larger - some of them up in the TCF range? How do you cluster it? I will say that there are also, in terms of development, what the development costs, how many fields we have to cluster to develop in the foothills. What terms are you going to put on exploration? Are you going to allow year-round exploration? There are a myriad of issues that go in that make it very difficult to quantify a meaningful economically recoverable number.

So, what we intend to do is put a synopsis of the existing data together with maps of basically a compiled version that could be useful. In talking with Patrick, that is more what the committee had in mind - could be useful to policymakers showing where the basins are, showing the current numbers, showing where the transportation route and how it might affect it and then looking at some of the new technologies that might be

involved. So, what we're going to give you is a compilation of existing data. I think any of these surveys give you - it's like the ANWR issue, any of them give you a large enough number. The question is, is it meaningful to say there's 100 TCF versus 150 TCF? Our opinion now is our crystal ball isn't clear enough and we don't have the data to do it properly. We probably will in a couple of years, but right now we don't.

CHAIRMAN TORGERSON thanked Mr. Myers and said they would next hear from industry and Mr. Alan Sharp.

MR. ALAN SHARP, Director of Northern Business Development, EnCana Marketing USA, Inc., said he was here today on behalf of EnCana to submit testimony on the Alaska Natural Gas Pipeline Act of 2002 and, more specifically, the Alaska gas floor price credit provisions. He gave the following testimony:

I'd like to start my testimony by explaining who EnCana is. We are one of North America's largest independent natural gas producers and North America's largest independent gas storage owner operator, which includes the AECO Hub, which was earlier mentioned as the reference price for the floor price provision. Our oil and gas production is located in the U.S. Rocky Mountain states, western Canadian sedimentary basin and the United Kingdom's North Sea, with recent significant discoveries in the North Sea, the Gulf of Mexico, and off-shore East Coast of Canada. We are an aggressive explorer on our North American lands focusing on natural gas. In particular, Alaska's lands are, in our view, highly prospective and offer potential to become a future production platform for our company and also North American. Clearly, EnCana has a vested interest in the efficient operation of the North American gas market which is why EnCana appreciates the opportunity to testify here today.

EnCana has an extensive land position of over 4 million gross acres of land in Alaska and we're referred to as the explorer as we do not have proven gas reserves, yet. The earliest we expect to have proven gas reserves in the Foothills is 2005. For this reason, access and expansion on the Alaska gas pipeline is critical for our success. Without future pipeline access on reasonable terms and conditions and especially timing, we will not be able to 'monetize' the gas we find and, therefore, EnCana would have to reevaluate spending money on gas exploration in

Alaska. The purchase of leased land is inexpensive relative to the cost of seismic surveys, drilling wells and commercial development. It is these later expenditures that create significant jobs and monetary benefits within and for the State of Alaska. One successful commercial gas discovery in the foothills is estimated to generate 3300 new jobs and \$6.4 billion of in-state benefits.

MR. SHARP said he would address the committee's questions, but he wanted to present EnCana's overall position first. He stated:

EnCana firmly supports the White House's position as stated by the Secretary of Energy in his letter to the Energy Conference, dated June 27, 2002. It states: 'The Administration strongly opposes the price floor tax subsidy provision in the Senate bill and any similar provision because it would distort markets, could cost well over \$1 billion in annual lost revenue, and would likely undermine Canada's support for construction of the pipeline and thus set back broader bilateral energy integration.'

EnCana has publicly stated that the gas floor price subsidy is an ill conceived and flawed proposal and that the market should be allowed to determine when it's economic for northern gas to flow. A gas floor price would provide an advantage to an Alaska gas producer to the detriment of all other North American gas producers and ultimately the consumer. The flow of subsidized Alaska natural gas would distort the gas price and disrupt the efficient operation of the market.'

MR. SHARP said he would now answer the committee's questions.

The first one was whether the Alaska floor price tax credit provision would be beneficial or harmful to the construction and operation of the gas pipeline.

The credit provision may or may not be beneficial to the Alaska gas line construction. The credit is payable to the shipper on the gas line, not directly to the pipeline owner. It's the pipeline owner who will construct and operate the pipeline. The pipeline toll would roughly be around \$1.25 per million btu while the floor price is \$3.25 per million btu. The credit provision is not meant to build the pipeline, but to insure the producers who are shippers are guaranteed a profit for the gas that

they produce. What is important to realize is that there are three different roles being performed: the producer, the shipper and the pipeline owner. When these roles are performed by one party, the potential for conflicts of interest and anti-competitive behavior can arise. When you ask, will the credit provision benefit the pipeline, it's important to note that it will depend on how the party performs these three specific roles and if conflicts of interest arise that may benefit one role over another. I think the real question that really needs to be asked is what do we want the future Alaska gas industry to look like? If there's limited access and capacity, there will be a limited number of players; there will be limited competition and limited exploration development. There will also be limited jobs. State revenue will mainly be from royalties of existing gas reserves such as Prudhoe Bay and Pt. Thompson and pipeline taxes. In a multi-player competitive free market, there will be access in capacity on the pipeline. There will be sustained growth, exploration and development. There will be more companies meaning more jobs in Alaska. The state revenue will be diversified with royalties coming from new yet-to-be-discovered gas pools and the creation of new support industries. This is what a vibrant Alaska gas industry could look like.

Building the pipeline does not guarantee a vibrant gas industry. We must have a future vision that defines the regulations on access, expansion, open seasons and pipeline tariffs. That kind of clarity will help create a competitive and vibrant gas industry.

The second question in the first section was whether the Alaska floor price tax credit provision would be beneficial or harmful to the Canadian gas industry.

EnCana does not agree with Section 704(2)(b), which presumes that sufficient downstream pipeline capacity will exist to transport Alaska gas past Canada to U.S. markets. The Alaska gas floor price removes the natural incentive for Alaska producer and shipper to insure adequate capacity will exist. As the credit provision stands now, it will be harmful to the Canadian gas industry. There is not enough export pipeline capacity to leave EnCana to handle both Canadian gas exports and Alaska gas volumes. This means Alaska gas will be stranded in Canada leading to an oversupply of gas and lower Canadian gas prices. Since the Alaska gas has a

Canadian based floor price, it has an unfair competitive advantage over Canadian gas resulting in Canadian gas being shut in. It will also be detrimental to Canadian gas exploration and development. Alaska gas will continue to flow while the Canadian gas industry suffers.

The next question was dealing with the Alaska floor price tax provision and would it be beneficial or harmful to the Lower 48 gas industry. It's really broken into two sections. During times when Canadian export pipeline capacity is restricted there will be no incremental gas flowing to the Lower 48, thus there will be very little impact to the Lower 48 gas industry. However, if the Canadian export pipeline capacity is expanded, then the Lower 48 gas industry will face the same competitive disadvantage and detrimental impacts as the Canadian gas industry. The risk in cost will essentially be transferred further downstream from Canada to the Lower 48.

The next question was dealing with the Alaska floor price tax provision and would it be beneficial or harmful to the Lower 48 consumer. Prior to the Canadian export pipeline expansion, the incremental gas supply will not reach the Lower 48 consumer. The consumer will be disadvantaged in two ways and will have to pay twice. The first is paying high gas prices as new incremental gas supply cannot reach them and the second is paying higher taxes due to the floor price credit provisions. The incremental gas trapped in Canada will cause low gas prices and trigger the Alaska floor price credit provision. After the Canadian export pipeline is expanded, the Lower 48 consumer should see a benefit. However, this is on the premise that the Canadian export pipeline expansions are delivering gas to an area where that gas can reach the Lower 48 consumer. If this is not true, then there will be localized areas of high gas prices for consumers and low gas prices for the producer, a detriment to both.

The last question in Section 1 was what there type of incentives would you support.

A key principle that must be met is to allow free market forces to work, provide a fair and equitable competitive environment. EnCana would support incentives that meet this key principle. However, EnCana is not convinced that a subsidy is required to support the construction of the

Alaska gas pipeline. Prior to any consideration of a subsidy or credit, EnCana believes that an independent study should be undertaken to establish the economic viability of the natural gas pipeline and the need for such a subsidy or credit. The pipeline should also be built all the way through to the U.S. market to insure incremental gas supply is not trapped in Canada.

The second set of questions was, starting with the first one, do you support the open season provisions in Section 704(e)? EnCana supports the guiding principles provided for the open season. FERC has been mandated to establish and govern the open season regulations based on Section 703(2), which states 'to establish a process for providing access to such transportation project in order to promote competition in the exploration, development and production of Alaska natural gas.'

Before EnCana can fully endorse FERC's open season regulations and procedures, we'd like to insure that all gas industry players have provided their input and their interests have been met. Some examples of concerns that we have in this area are the initial Alaska gas pipeline volumes must have adequate downstream facilities to deliver incremental gas to U.S. markets. This means initial open season holders should be treated the same as expansion open season holders as per Sections 706(b)(8).

The next concern we have is how competition will be created as per the purpose provided under Section 703(2). The last concern is - is 120 days enough time for FERC to create fair and equitable open season rules?

The second question in that section was, do you support the pipeline expansion provisions as per Section 706?

EnCana supports the guiding principles provided for pipeline expansion and we would like to insure that the expansion rules are based on Section 703(2), which is the creating of competition and that expansion shippers are treated the same as initial open season shippers. We would also like to recommend that expansion wording in the open season Section 704(e) [be] repeated in expansion Section 706 to clarify the intent of future expansions, which we believe will help promote competition. The wording in this Section 704(e) that we'd like to repeat is: 'For an open season for capacity beyond initial capacity provide the opportunity for transportation of

natural gas other than from Prudhoe Bay and Pt. Thompson units.

The third section of questions were do you support instate needs such as under Section 704(g)(h) and 709(c)? EnCana supports the instate needs, instate rate coordination and the Alaska royalty gas provisions. However, there are some areas the state might want to consider such as under Sections 704(g) - to insure the tie in points referred there are for both receipt and delivery points and also under 704(h) to clarify who has jurisdiction over gathering and processing facilities.

The last set of questions dealt with do you support other incentives in the Pipeline Act? EnCana believes that incentives should apply to all parties in an equitable and fair manner, which enhances competition and free market forces. The other incentives within the Pipeline Act that EnCana supports are the expedited process, Section 703(2), which promotes competition, having FERC as the leading agency with the power to govern open seasons and expansions and Section 710, which is the loan guarantees for the pipeline.

To conclude, I will reemphasize EnCana's position. EnCana is not convinced that a subsidy is required to support the construction of the Alaska gas pipeline. Prior to any consideration of a subsidy or credit, EnCana believes that an independent study should be undertaken to establish the economic viability of the natural gas pipeline and the need for such a subsidy or credit. If the U.S. government believes that there is a requirement to access additional gas supplies to market intervention, then EnCana suggest that any support go directly towards the development of transmission infrastructure, meaning the Alaska gas pipeline and corresponding gas pipelines to the U.S. markets. Thank you for inviting EnCana to testify today and I'd be happy to answer any questions you may have.

CHAIRMAN TORGERSON said he was perplexed by his comments that this might strand Canadian gas. He explained:

Two points. The first one is that we've sat through a lot of presentations from the Alberta government that the Hub that is currently established in Alberta can with a few modifications, handle the gas now. Personally, I question that on a 4.5 billion bcf/d volume, but they have still

made those presentations and still stand by the fact that there would be very little infrastructure needed if we use the existing hub. That's one issue that I probably don't believe it's stranded gas, if you believe the Alberta government.

The second one is that the producers own the plans to build the additional line from Alberta to the Midwest so it would be just a flow through except for maybe some liquids that may or may not come out in Alberta. So, having those two things out there, how could I make the assumption that we would strand Canadian gas?

MR. SHARP replied:

I'll answer the second question first which is the building of the additional line. My understanding of the Act is that it's not mandatory that they what they refer to as the B to C line has to be built. If that line was built, then the gas would not be stranded in Canada and it would not impact the market. So, that would be definitely something we would be in favor of, but there is nothing as far as I am aware that actually would force that to happen. If that B to C line is not built, then it really comes down to looking at how much gas supply is in Alberta, such as Alaska gas coming in, Mackenzie gas, the existing production from the western Canadian basin, subtracting off the intra-Alberta demand and then whatever supply is left over, is that amount greater than or less than the ex-Alberta take away capacity or essentially the export pipeline capacity to the U.S. markets. And our projections show that if 4 BCF/D of Alaska gas comes down, you will strand gas in Canada.

REPRESENTATIVE DAVIES said they have heard statements about the supply and demand in the Lower 48 U.S. market and the numbers were that the market is expected to grow 7 - 11 TCF in a 20-year timeframe and that the supply of gas is pretty limited and asked him if he disagreed with that characterization of the U.S. market.

MR. SHARP replied that they believe the market demand will grow and are working internally as to whether it will be 4 BCF/D or 6 BCF/D of incremental gas. Their main issue is the bottleneck that would be created if you bring down the incremental gas and the U.S. consumer is expecting to receive that gas and it just can't get there because there's not enough pipeline to take away capacity from Canada to the U.S. They are working on the demand projections and think that 4 BCF/D could probably be absorbed, but if you go

higher than that, there could be some issues.

It's difficult when you're forecasting supply and demand, because it really comes down to many assumptions both on the supply side as well as demand, especially on the economic growth and we're talking out in 2010. It's quite difficult with the number of assumptions you're making to narrow that down.

REPRESENTATIVE DAVIES wanted to ask him a general question about the issue of government subsidy of these things.

On a really big project like in any version of an Alaska gas pipeline would certainly be classified as among the biggest in the world, just getting something like that to happen because of the huge risk involved, it seems like it's almost going to have to involve some kind of assistance beyond just the normal marketplace. I guess I'd just like you to compare that to a much smaller, but closer to home example and I think in terms of the Alliance Pipeline. It's my impression that there was some governmental participation in that to begin with and then they phased it out. Is my recollection correct on that and could you comment on the appropriateness in general of governmental assistance in getting some of these bigger projects to happen?

MR. SHARP replied:

With the Alliance Pipeline I'm not aware of any government assistance. I can check into that for you. I know that when the Alberta gas industry was first created, there was governmental support on the trans-Canada pipeline back in the 50s. It was in the form of loan guarantees over the Canadian shield part into eastern Canada. So, that has happened. Alliance Pipeline, I'm not aware of that.

REPRESENTATIVE DAVIES asked if the government has no role in developing frontier gas provinces.

MR. SHARP replied that he wouldn't say that. He told members:

If a subsidy or credit is going to be provided, then I think all the information should be on the table. If we specifically talk about Alaska, the producers had a \$125 million study. There's a lot of information out there that has to be shared. I think when I answered the first

question about is it beneficial to the pipeline or not, really the floor price is benefiting the producer and if it's really the pipeline that you want to go ahead, then shouldn't the subsidy or the credit be directed towards the pipeline owner and the pipeline itself? That's really where we're coming from. We want to make sure the pipeline infrastructure is in place. So, provide the credit directly to the pipeline if it's the pipeline you want to proceed. If it's having to do with security of energy, then maybe the subsidy should go more in a general sense to those that provide energy so that you're creating more supply of energy from that credit.

REPRESENTATIVE DAVIES followed up saying:

Obviously those issues can't be separated. People can't get money to build a pipeline independent of being assured of some shipment and production of gas. Those things are clearly tied together.

MR. SHARP replied that yes, they are tied together, but he would ask if the proposed floor price is the proper amount and is it the proper mechanism.

If you look at a \$3.25 floor price versus a roughly \$1.25 toll, there's a \$2 price that goes to the producer. What is the rate of return on that price and what is the price that they need for a rate of return? What is that minimum acceptable amount? I think that's the question that has to be answered.

REPRESENTATIVE DAVIES agreed, but asked, assuming those numbers were correct, whether he would support it.

MR. SHARP replied, "No, it would harm the Canadian industry. It really is unfair advantage that the Alaskan producer would have over..."

REPRESENTATIVE DAVIES said his point of view is that it is not correct.

MR. SHARP replied:

I was trying to answer your question. With that type of subsidy, I think one of the questions I would ask is what type of rate of return is the producer making with [that] type of a floor price? If you think about Prudhoe Bay, it was an oil pool that basically found all the profit - all

the infrastructure has been paid off on the oil side and you're basically going down the gas side. It should have one of the lowest supply costs of gas, because you can utilize a lot of the existing infrastructure to produce the gas cap.

REPRESENTATIVE GREEN asked if a major 4 BCF gas field were discovered in the area of the hub, would that pose the same concerns to him about a problem with other Canadian gas fields as the subsidized gas coming from the North Slope.

MR. SHARP asked if he meant would the 4 BCF/D compete.

REPRESENTATIVE GREEN replied:

Yes, would that create a problem against other Canadian gas entities? That's what I understand your concern is. When you're saying unfair competition, you're talking about Canadian competition.

MR. SHARP answered:

If someone discovered a large amount of gas in the western Canadian sedimentary basin, kind of within the existing supply basin, there would be gas and gas competition and essentially if that large quantity of gas was discovered, it would compete without a floor price against all the other gas. So, then the free market competition and environment force is at play. So, if that large quantity of gas had a lower supply cost, it may delay other gas exploration and development if it had a higher supply cost.

REPRESENTATIVE GREEN said if that's the case 10 years from now and there is a demand and supply in the Lower 48 area, did Mr. Sharp think the free market forces would supply additional pipelines out of Canada to take either the discovered gas in the western sedimentary basins or the Alaska gas that ends up at the hub. He thought this would enhance the gas situation.

MR. SHARP replied, "I would agree if there was no floor price in effect."

He explained if the Alaska gas is flooding the Canadian market with gas and can't get out of that market area, it would share the same price risk. There would be a natural incentive for the Alaska gas producer and some Canadian gas producers to expand the pipeline past capacity to move it to the Lower 48 market. However, in regard

to an Alaska gas producer with a floor price, he asked:

Why you would take on the additional risk to expand pipelines downstream and that long-term commitment to do so if you've already got a floor price in the market that you can dump it off into?

REPRESENTATIVE GREEN said there has to be some sales for them to dump it off.

TAPE 02-8, SIDE A

MR. SHARP explained that each country keeps selling the gas and the price gets lower and lower until eventually the Alaska gas displaces the Canadian gas that's being produced.

It would be the Alaska gas that would flow in the existing pipeline infrastructure and existing markets, because if they sold it for a very low gas prices, they are still guaranteed that higher floor price. So, they don't really care how low the Canadian gas price goes and you're backing out the Canadian gas, which would have flown on the existing pipeline infrastructure.

REPRESENTATIVE GREEN said he was talking about 10 years down the road when the demand is at a significantly increased number.

MR. SHARP replied that is correct. They have projections, but unfortunately they weren't ready for this meeting. He stated, "We have shown that it can absorb the full 4BCF/D in the year 2010 so there will be displacement."

CHAIRMAN TORGERSO said he was assuming that he opposed the deepwater Gulf credits and other credits that other competition has against the Canadian gas.

Clearly, we're not on the leading edge here with incentives or the downside risk protection or whatever you want to call this. It's happened all over the world and certainly the Canadians have been one of the leaders in it as far as subsidizing remote areas or oil sands or Hibernia or some of the others. Now you're saying you don't like this Alaskan gas because it apparently impacts you, but we're okay with all the other incentives that are out in the world - just don't like what Alaska is doing. I'm having a hard time connecting the dots.

MR. SHARP replied that he wasn't aware of the type of the credits

that exist in the Gulf of Mexico. In Canada they use royalty holidays, tax credit provisions, but those have mainly been directly to the producer if you want more energy supply and you apply the credit directly to that source. He used an analogy of what would happen if there was farmed salmon off the coast of Anchorage and the owners, who have a subsidized price, dump it for what they can get for it in Alaska. It kills the Alaska salmon price, but they'll keep dumping their fish into Alaska, because they don't care what the price is because their government has guaranteed them a floor price for their salmon. He continued:

But what it's done to the Alaska salmon industry is decimated it, because there's no longer a price there that the existing infrastructure and existing salmon industry can survive on. That's kind of the analogy I would use for the Alaska gas coming down to Canada. If we don't insure that there's that infrastructure to insure that it gets out of Canada and to the U.S. consumer, you're going to end up decimating or having significant negative impact to the Canadian gas industry.

CHAIRMAN TORGERSON asked why they didn't oppose all of Section 29 credits that are in the energy bill [H.R. 4]. It's the same thing and has the same effect of subsidizing the gas price.

MR. SHARP replied, "I think with the floor price it only applies to Alaskan gas."

CHAIRMAN TORGERSON responded that he was making a comparison to other things that are happening in the industry on both sides of the border. It's no different than subsidizing through a royalty or whatever else is going on. He said the producers have called the royalty in kind (RIK) sale a subsidy to Canada and asked him his opinion of that.

MR. SHARP replied that they view the RIK sale as a competitive bid.

CHAIRMAN TORGERSON said although he didn't want to go into it at this time, an RIK sale is considered a subsidy to them "in our own back yard."

MR. SHARP replied, "I guess I don't see it as a subsidy in the sense that we competed for the royalty in kind sale and that's at a premium to the alternative, which would be to royalty in value."

CHAIRMAN TORGERSON replied, "We're competing, too, with Section 29 of the deep water Gulf and imported LNG."

SENATOR OLSON said that EnCana is a very sizeable company and asked how much energy they are putting forth to advance extracting resources off the North Slope compared to their other holdings throughout the world.

MR. SHARP replied:

We're quite serious about it. As I mentioned, we have 4 million acres of land in Alaska. Essentially, the biggest issue that we have for Alaska gas exploration is really access to the pipeline. If we can get access to the pipeline, we're fully there. The royalty in kind sale that Senator Torgerson had mentioned, we view that as kind of something within the power of ourselves and the state to insure that we actually do have access and capacity on the pipeline. Failing that, we're looking at this Pipeline Act through the open season and the expansion provisions to provide us access to the pipeline. So, we're very serious. It's just a matter that we have to have access to the pipeline to be able to 'monetized' whatever we find.

REPRESENTATIVE FATE said the Alberta Minister of Energy mentioned NAFTA to gain market share of Canadian gas and asked if they entertained any of that in their proposals or statements here.

MR. SHARP replied that he hadn't and he wasn't aware of the Minister's comments, but he would look into that.

REPRESENTATIVE FATE said they are concerned the excess gas coming down is in competition with the North Slope gas and he noted the statement was made in Washington D.C.

CHAIRMAN TORGERSON said there was an article in the Canadian Herald a couple of months ago related to Alberta government attorneys' view of whether or not the subsidy violated NAFTA. They determined that it did not on the basis that Americans would be moving a product from one market to another that happened to travel through a foreign country.

REPRESENTATIVE CHENAULT asked how long the Canadians entertained negotiations with the Canadian groups about pipeline costs and incentives from the Mackenzie down.

MR. SHARP replied that he wasn't aware of any talks of that nature. He thought one of the pipeline owners had been talking to the government about that. He reiterated that EnCana is an explorer on the Mackenzie side as well and conversations like that would be by

the producers or the pipeline owners with the government.

CHAIRMAN TORGERSON said he heard there was a request to borrow \$1 billion for the aboriginal part of the ownership and there's some talk about royalty relief.

REPRESENTATIVE DAVIES said he felt a certain amount of tension in his position as an explorer and wanting access to a pipeline that doesn't exist yet. He asked, "Don't you feel a little bit of a tension on the one hand testifying against some subsidy that would help make a pipeline exist and on the other hand asking for access to the pipeline?"

MR. SHARP replied:

I think what it comes down to is we want to make sure that the Alaskan gas supply comes on in basically a manner that does not back out other gas supply, which maybe should have from a supply cost or kind of a free market environment come on first because you can kind of look at the existing basin development. It should have the lowest supply cost and, in this case, including the pipeline infrastructure to get it to market. And then as you progress out to say, coal bed methane, deep water Gulf of Mexico, it could be off shore eastern Canada, each one of these supply areas that could supply gas to meet the future needs of North America will have a certain supply cost on it. So, if you go through that supply cost order, if you subsidize one over the other, you're disadvantaging, I think, the market.

REPRESENTATIVE DAVIES granted him that argument, but asked if he wasn't at the same time advantaging their particular investment on the North Slope.

MR. SHARP replied that they would, but they look at it as a portfolio of supply all over North America, which will get developed over time.

If one disadvantages another, they have a vested interest to insure that it doesn't hurt our portfolio. We'd like to see the free market forces bring that on in an orderly and cost efficient manner.

CHAIRMAN TORGERSON thanked Mr. Sharp for his testimony and said he would like to finish the industry testimony before taking a break.

MR. MARK HANLEY, Public Affairs Manager, Anadarko, said Anadarko is

a very large independent with a lot of acreage that believes there is a lot of prospectivity in Alaska. He told members, "We are excited to be here."

He said Anadarko is comfortable with the proposed resolutions. Whether the credit provisions are harmful or beneficial, Anadarko believes that if they reduce the cost or the risk, they will improve the economics of construction of a pipeline and increase the chances that it will be built. Whether they help or hurt the industry depends on one's position in it and ultimately on the actual price of gas when it is brought to market. He continued:

Clearly there are different opinions on what it will do to the market. Some have scored it that prices will remain above that level and it will not impact the market. So, it's a judgment call, I guess, in some respects. We do think that having this amount of gas coming into the market will have some dampening effect on prices and that doesn't mean they'll drop, but clearly not having this gas in the market - it's a significant amount. It's either going to slow the growth in prices or it could have a slight decline in the prices as Mr. Myers has suggested. Some reports suggest it could decrease the price for a short time before it actually grows again. That could be bad for a gas producer if you have gas existing elsewhere, because relative to everything else, you would have received higher gas prices for your gas. I think clearly for the consumer, if it has that dampening effect, it's a benefit. So, it's a matter of what you think the crystal ball is going to say out there a few years from now.

When you evaluate the potential impacts of the incentives in this bill, it's important to recognize that Alaska gas does compete with gas from other regions. Those regions have other incentives; some are existing and some are being proposed and which incentives are worth more is often a judgment call, but they all affect the economics of the projects. So, as you said, Section 29 - different people have different royalty rates; that's a straight if you have a 20%, somebody else is at 10; is one a subsidy? I don't know; it's a difference in relative economics, but one can make a big difference in how you propose it. So, I think it's important as you have pointed out to recognize that there are a lot of these things out there and it's not just an apples-to-apples comparison a lot of times.

You've asked about the open season provisions as well as the expansion provisions and I think we've been pretty adamant about access. That's where we've really focused in Congress, particularly as having fair access at a reasonable price. So, we do support those provisions...

To be brief the in state needs, rate coordination and royalty gas provisions we're supportive of those as well. As far as the other incentives in the Pipeline Act, I guess we would say it's up to public policy makers to look at those and see how much in the way of incentives are necessary to get this project built and that's really a policy call for folks like you and people in Congress.

We would like to see a gas line built that will allow commercialization of Alaska gas. We do believe that there is going to be increased demand for gas and that the decline of U.S. production will create a favorable fundamental for commercializing both Alaska and Arctic gas in the Canadian Arctic and that both can be viable. Consumers are going to need this gas to prevent possible gas spikes as demand outgrows supply and particularly the administrative portions of the bill should help expedite the pipeline's construction and help insure reasonable access to the pipeline. Your letter suggests that you are going to look at things for future recommendations and I guess we would just continue to request that the state insure and encourage continued Alaska gas exploration by doing what it can to provide fair pipeline access at a reasonable price to new gas as well as already discovered gas.

CHAIRMAN TORGERSON asked if Anadarko was going to actively try to advance any amendments to the energy bill [H.R.4].

MR. HANLEY replied no. He said they are comfortable with the agreements represented in the bill. "As you said, the minute everybody tries to push one little work or change to that, it can be a free for all."

REPRESENTATIVE GREEN asked if Anadarko has a feel whether the market will be able to absorb 4 BCF of gas in 10 or 15 years.

MR. HANLEY replied that his company believes that both Canadian and Arctic gas are going to be needed. They see a growth, particularly in the U.S., for demand and an increase in the decline rate in some of the existing fields. They see the fundamentals as being very strong for this kind of volume plus more.

REPRESENTATIVE GREEN said that it may be that concerns about the incentives being a deterrent to free market trade might be a bit overplayed.

MR. HANLEY said he didn't want to oppose someone else's arguments. They see the demand in the U.S. for significant volumes of gas above and beyond 4 - 5 BCF/D.

CHAIRMAN TORGERSON thanked him for his testimony and noted that they had written testimony from BP and Robbie Schilhab with Exxon and Yukon Pacific Corporation.

MR. ELLWOOD, Executive Vice President and CEO, Foothills Pipe Lines Alaska Incorporated, said before he responded to the questions he wanted to emphasize the principles that have guided their participation in this process in Washington, Alaska and Ottawa.

Foothills and its shareholder companies believe unequivocally that the North American energy markets will need both Alaska natural gas reserves as well as the reserves to be unlocked in the Mackenzie Valley in the Canadian Northern Territories. We have never approached the development of these resources as competitive or exclusive; we have devoted resources and continue to devote resources to develop the necessary transportation infrastructures to access both regions. We have consistently advised federal, state and provincial governments to very carefully consider how to assist in the approvals and financing for the infrastructure that will be needed to process and transport these remote mass resources to the market. Beginning in the mid 1970s, all levels of government in the United States and Canada have recognized that the enormity of the capital commitments and risks associated with developing hydrocarbon resources in these frontier areas require very focused coordinated efforts to assure prompt and reasonable regulatory approvals and oversight. ANGTA here in the United States, the Northern Pipeline Act in Canada, and the agreement on Prince of Wales between Canada and the United States are examples of such coordinated efforts. Attention has been paid over the years to understanding and resolving some of the economic and financial risks which face producers, transporters, marketers and ultimately consumers as they undertake the investments and commitments necessary to finally access these much needed supplies.

The North Slope producers have identified the need for federal enabling legislation or some mechanism of risk sharing or risk mitigation. Producer commitment to this project is necessary if it is to become a commercial reality. What has evolved through the legislative process in Washington is a significant degree of consensus between all interested parties on the types of risks that face the project and the need to address them. We believe this project is in the national interest and, therefore, we do not oppose the provisions in the current version of H.R. 4.

Relating to the specific questions Mr. Ellwood said:

Specifically relating to the market risk provision in Section 25.03, we certainly respect the efforts of Phillips Petroleum, in particular to think creatively and to come up with a mechanism, which would be triggered only if gas prices at the given pricing point were to fall below some value. If this mechanism is sufficient to obtain shipper commitments, then it will definitely assist development of project since the producer commitment is what has been missing for the past 30 years.

The provisions of Section 704 (e) relating to the regulation of open seasons for capacity on any transportation system are acceptable to us. Regulated interstate pipelines in the United States, and increasingly in Canada, as well, are routinely conducting open seasons for development of new projects and for the allocation of their capacity. We are familiar with the efforts of FERC under its open access regulations and those are promulgated pursuant to the Natural Gas Act. [Indisc.] those efforts to assure that adequate pipeline capacity is developed and that such capacity is allocated without undue discrimination. We are comfortable that given this precedent, FERC will implement these new provisions in a manner that will not impose unreasonable or unnecessary risks on the project nor impair its financability.

With respect to the pipeline expansion provisions of Section 706(a) - (e), it's widely known that as pipeline companies, we do not believe these provisions were necessary. If a pipeline expansion is economic, then the pipeline companies will make the investment necessary to build that infrastructure. After all, that is how we earn

a return on our investment. However, it became clear to us that if certain market participants, particularly the explorers, as well as State of Alaska, wanted additional assurances that economic expansions could be ordered. Such powers resting in a regulatory body is somewhat unique, certainly not in our view, a hallmark of the pipeline industry in the United States. But in an effort to forge a compromise, we worked closely with the Senate Energy Committee staff and representatives of other interested parties and groups to hammer out the compromise mechanism that's reflected in Section 706 as it presently stands. We, therefore, have indicated our acquiescence to these provisions and we would disfavor any effort to change it.

With respect to provisions governing instate needs, Section 704(g) and the Alaska Royalty Gas Section 704(h) and the instate rate coordination in Section 709 (c), the provisions as written are consistent with the general requirements of ANGTA and the president's decision selecting ANGTS. However, these provisions if implemented reasonably, should not impose unnecessary burdens, risks, or costs on the project. As written, they are acceptable to us. Again, we would likely oppose any effort to modify these provisions, which were very carefully drafted not to impose debilitating risks or costs on the project. And with respect to all other aspects of the bill, Foothills has previously indicated its support for those. Thank you for the opportunity and I'm prepared to answer questions.

CHAIRMAN TORGERSON asked, based upon his last testimony, does he not intend to advance any amendments on behalf of Foothills or Duke. Mr. Ellwood indicated that was right for Foothills and that he couldn't speak for Duke, but he understood that they didn't intend to.

MR. JOE MARUSHACK, Phillips Petroleum, said they have a long-standing plan that they are going to implement to the extent they have the ability to do so. He commented:

That includes continuing to pursue federal enabling legislation as in the Senate version with no modifications. It includes pursuing federal fiscal legislation with a few technical corrections that we could talk about if you wish later on. If we're successful there, we will move forward and try to address state fiscal legislation similar to that that was in HB 519 last year.

Let me expand on these points a little bit in some detail. For two years Phillips has been working hard to commercialize gas via the Lower 48 pipeline. Obviously there is a lot of benefits to the state. There's huge benefits to the governments; there's a lot of benefits to other industries out there and consumer groups. Let me start out by saying that I've met with a lot of consumer groups and once they understand what we're trying to do, I've not met a single consumer group that has a problem with the tax mechanism. It doesn't mean they don't exist; it just means the people I have talked to, after they understand that more gas is good for the Lower 48 consumer, they are supportive.

Last spring, Alaska's D.C. delegation asked what it would take to progress a project. With partners, I should say with BP and Exxon Mobil, we developed the enabling legislation. Separately, we addressed a federal tax mechanism to share the risk with the ultimate beneficiaries and we pointed out that at that point in time, if we were successful, we would move forward with state fiscal issues. Assuming there were no more risk mandates, the next step would be to initiate the permitting process on the southern route. That's where we've been and that's where we still are. We continue to favor the southern route. It has fewer unknowns; that means lower risk. It has timing advantages; again, that means lower risk. It has less opposition and less contentious issues in permitting overall less commercial and technical risk, although the risk is still high. In fact, yesterday on the TV I heard someone say there was no risk with this project if you got to take the Senate tax mechanism. That is not true! This is a \$20 billion project. The last big project like that had an overrun seven or eight times. We can't afford anything like this. There's huge construction risks associated with that and I don't think you've met any industrial or engineering firm up here who has said there weren't, but we have addressed an important risk and that's the risk associated with volatile markets.

This year we have been focused and almost solely focused on the legislation that will make the project viable. Within the enabling legislation, I agree with most of the comments that you've heard before hand. We originally proposed language that we thought was clear and limited to federal action. Throughout the process other parties

participated in that and there was some modifications in the Senate debate. I don't think anyone is completely happy with the Senate version, but we have a delicate compromise and we don't think that it's appropriate at this point in time to try to be making changes on the conference floor. In terms of the federal enabling legislation, I've heard a lot of misstatements about it, even today.

But let's be clear on Phillips with you on this. This federal fiscal legislation is absolutely critical to moving a project ahead. If we don't have that, there's really no need in our view to address any state issues. So, we haven't attempted to address those.

The key thing to recognize, it provides a risk mitigation mechanism to an income tax credit at unexpectedly low prices. There is not a floor price. The market will be what the market is. What happens is when you hit the \$3.25 AECO mechanism, you get a federal tax credit to the extent that you are a taxpayer in the U.S. If you don't have sufficient income taxes, the credit is not worth that much. Hopefully, we'll be a taxpayer in the Lower 48. The joint tax committee did score it at no cost. That means that they had a mechanism out there, a price score cast that they thought looked reasonable that had no associated government revenues associated with it. Other price forecasts may have a cost associated with it; this one does not. The legislation provided for repayment in high-priced periods to the extent you have ever used a credit.

The North America consumers will absolutely benefit from another source of clean, stable, domestic energy. And we can talk a little bit about what 4 BCF means and where it comes from and what kind of commitment it takes to make that happen to the Lower 48 market. The loss of supply and demand will still set the market price of the gas. This is not a floor on the price.

What's needed, Phillips will be pursuing some technical corrections to the fiscal part of the bill. Otherwise, general support from Alaska in the Senate will be helpful. We're not advocating any alternatives at this point in time. We're advocating the position we've had for well over a year. We're committed to making progress on state fiscal issues to the extent that we get the legislation that we need in Washington. Those, again,

would be clear, they'd be certain, and regarding state incentives, we will be seeking some modifications on the tax side.

Senator Torgerson, that presentation you had there was a BP presentation. It was not a Phillips presentation; I was invited to sit in on that and I did sit in on that, but I do not agree necessarily with all the points that are in there. Clearly, there is nothing in there about state fiscal incentives, but we think we would be pursuing those. But there are other issues in there that we think are probably not our view of how those things should be done in the future. Nonetheless, it is a starting point and there are a lot of things in there that we would agree with. Again, we don't think the timing is necessarily appropriate.

We will be pursuing a version of something similar to HB 519. We thought that was a good approach. We thought it made use of existing state processes to enter into confidentiality agreements to share information, yet there would still be a public process and a way of negotiating and ultimately bringing forward a contract or some sort of mechanism that the legislature could look at and make comments and hopefully approve. And finally, strategic incentives when most needed by the project, we would be pursuing those in the future, too.

So, in conclusion, other than a few dot points I'd like to make at the end, we will continue to pursue success along these lines. There's nothing new here. We've been here well over a year and we've been consistent in this. We ask the committee's support for this strategy. It's one that we believe can progress in the Alaska pipeline project.

Just a couple points that I may not have addressed in the ultimate dot points here beforehand - cost overruns - cost overruns are still a certainty. There is nothing in the tax mechanisms that would keep that from happening. Representative Green, you asked about inflated costs. The cost of the pipeline project that we see now, including gas treatment plant, NGL facility, and a mechanism to go all the way into the Lower 48 is \$19.4 billion in 2001 dollars. That would be inflated for dollars of the day and depending on the timing of that, it's \$25 - \$27 billion. It's important to note that Phillips, BP and Exxon did design a pipeline all the way to Chicago. The

idea that we're going to strand Canadian gas is nonsense. We have looked at either building a line ourselves to get it to market, but a better solution and one that's win/win for everybody, is that the Canadian infrastructure, the pipeline companies, TransCanada, Foothills, Duke, Williams - all those companies expand their systems so we're not just going to Chicago, but we're going to other places. That's how we potentially get the best price for that gas. But, we're not going to strand Canadian gas.

Furthermore, Phillips is on record as supporting two pipelines. We believe an Alcan pipeline needs to happen; we believe an Alaska southern route project needs to happen. The Mackenzie Delta line has got to be an easier thing to do than we're trying to do. It's 900 miles; it's small diameter; it's ready-made steel; it should be able to be done if you can get through the regulatory processes sooner than our project simply because of the size of the magnitude. We're four times as big as that. In any regard, we think there is room in the market for both of those projects and regardless if Alaska gas comes first or if Mackenzie Delta gas comes first, we are going to have to have expansion out of Canadian infrastructure. Again, we'll do it if we have to; we hope the Canadian infrastructure will see a better way of doing it themselves.

I think that's most of what I wanted to talk to you about. In terms of the mechanisms, what we've been pursuing is something similar to a trigger mechanism such as the AECO mechanism that we've talked about here. The other items that we think are necessary to move this project along from the petrol standpoint. But actually, the idea of the tax mechanism is you don't want to use that tax mechanism. It's a safety guard, if you will; it protects in cases of a low price environment. It doesn't affect the economics of the project except if you did ever have a very low price scenario, and then, of course, it does provide a tax credit to the extent you can use that to get up the \$3.25 AECO price, but this still leaves us with a very, very challenging project. So, we'll be pursuing investment tax credits on the gas treatment facility and seven-year depreciation on at least the U.S. portion of the pipes. We'd also like seven-year depreciation in Canada. So, hopefully the Phillips position is clear; it's not new and I'd be happy to answer any questions you may have.

CHAIRMAN TORGERSON said he understood that the White House wasn't too keen on a tax credit and asked BP to come up with an alternative. He asked if BP has proposed any alternatives to the floor and if so, what his position is on them.

MR. MARUSHACK responded that they had been asked for alternatives, not only by the Administration, but by the Senate Energy Committee, but they stand committed to where they are right now.

The reason for that is because we have been pursuing this for over a year. We've been very clear on how to move the project forward, the tax mechanisms that are necessary. We recognize that the more that you have confusion about what works and what doesn't work, it gives people the opportunity to say, 'This one I can do; this one I can't do. This one costs; this one doesn't cost.' And we just try to be crystal clear on what it takes to make a project happen. The worst thing in the world that can happen is we throw up a bunch of alternatives there. In conference committee, people pick and choose a few things and Phillips would say if it doesn't meet the basic requirements, we're not there guys. We do have a plan of how to do it; we've been clear on how to do it, but we're concerned about giving people the opportunity to cut and paste, pick and choose.

So, our position is that we do not support changes right now. We have evaluated all the mechanisms and frankly I can tell you some of them probably could work so long as they are a package that's put together that makes sense. But the concern is who knows what's going to happen on the floor out there. So, we think the prudent course of action is, 'You asked us what we needed; we've told you what we've needed; we're pursuing that strategy.'

CHAIRMAN TORGERSON said he wanted to focus on the BP proposal, which uses wellhead values. That was originally Phillips' proposal.

MR. MARUSHACK said it was very close to what they developed.

CHAIRMAN TORGERSON asked if that ends up being the mechanism, would he be all right using it.

MR. MARUSHACK replied:

Senator, I think what's important to be clear here is we have worked this project all the way to our most senior

management levels, to our chairman's level. When we've said here's a plan on how to move forward, what we're also telling you is if all these things happen, we'll invest another several hundred million dollars in this project. Now, that takes a lot of guts and takes a firm commitment on someone's part. So, at this point in time, Senator, I understand what the BP proposal is and I understand the economics of that. We continue to say, 'Let's stick with what we've got; let's pursue what we've got and let's be successful there.'

CHAIRMAN TORGERSON responded that he agreed that they had been crystal clear about what they needed and he was trying to get a handle on what was going to surface at the top. He asked, "Does the BP proposal have more votes than yours?"

MR. MARUSHACK replied that he didn't know what was going to happen ultimately.

I think it's going to be a tremendous struggle. We're going to do everything we can to make it happen. I don't think it's a slam dunk. My hope is that many of the consumer states will understand the value of this and pursue it. I think it's very, very dangerous for producing states to be saying we don't support a mechanism like this when we have got benefits of royalty credits in the Gulf, when we've got Section 29 credits; I think it's very very difficult in my view given the Hibernia situation, given the Northwest Territories situation, given the oil sands. I think folks need to be very careful in saying that they don't support this, because this is not for the three big producers. This is for all Alaska gas that comes in for a certain period of time and the Lower 48 wants more gas. They see the benefit of more gas not less gas. To the extent this mechanism doesn't happen, this project won't happen, I believe. So, I think people need to be very careful of what they say, especially producers.

CHAIRMAN TORGERSON said he understands and his recommendation to the committee is to support the price floor, but he also knows that they aren't going to have time to meet again if the BP thing happens to be the one that comes to the top. "That's why I'm pursuing this line of questioning."

MR. MARUSHACK said they had been clear with the delegation that the AECO mechanism is where they need to go and the reason is primarily so they don't get into a confusing situation where people cut and

paste and something doesn't happen. "The folks in Washington will be able to tell exactly what Phillips has said. There is nothing different."

CHAIRMAN TORGERSON said he talks to them a lot and this is for our record, not for their record.

REPRESENTATIVE GREEN said he was impressed with Mr. Marushack's statement that once the gas gets to the hub there are several markets that would be ready and willing to take the additional gas.

TAPE 02-8, SIDE B

MR. MARUSHACK said:

This is a once in a generation opportunity for Canadian pipeline companies. To have 4 BCF/D is small in terms of the 76 BCF/D that the Lower 48 needs, but in one slug to come through at a specific period of time is highly unusual and it's a lot of opportunity for the Canadian infrastructure there. The win/win I've long claimed on this was that, yes, through conventional means of expansion, twinning, looping, whatever it is, that there be the opportunity for a lot of companies to participate in this in the Lower 48 infrastructure. I believe that there's a way of doing that cheaper. I don't believe at the end of the day frontier pipeline always requires the major producers to make a commitment to make that happen. But in the infrastructure, I think there's tremendous win/win there, plus the market issues you addressed.

CHAIRMAN TORGERSON wanted to make it clear that he had no regulatory changes, but only financial changes to the bill, tweaking the floor.

MR. MARUSHACK said that was correct.

12:35 p.m.

REPRESENTATIVE JOULE said in his North Slope district they strive for working partnerships and he hopes that as legislation is developed, people are brought to the table earlier as opposed to being drug into the partnerships kicking and screaming:

Because there were some concerns with that in particular by the people of the North Slope who in different aspects of developing the resources of the North are constantly

looked at and asked for their blessing on certain things.
I know that was not the case with HB 519...

REPRESENTATIVE FATE said his comment was also on HB 519 and how Mr. Marushack alluded to, if not the necessity, certainly a favorable position the state might enter into relative to a bill similar to HB 519. He asked what happens if there is a final solution to the congressional conference committee and they get the incentive package that they are looking at. "Is there still going to be a necessary companion piece of state legislation with an incentive in it?"

MR. MARUSHACK responded to Representative Joule by saying the HB 519 was not a Phillips' bill, but they weighed in on it when it became public. He commented, "I agree with you. This needs to be a process that's vented much more timely. More people need to understand that and that needs to be worked to a much broader degree next time."

He said with regard to Representative Fate and the state tax mechanism, they have a plan, which consists of mitigating the risk. He explained:

It's not a floor; it's a tax mechanism that triggers at a certain price on tax credits. When we say floor, that means things to people in the Lower 48 that they are going to have to pay a higher price for gas and they will. In any regard, the plan is to mitigate some of the market risk through the AECO mechanism and then work on how to make the economics of the project better and there's a number of ways we're going to make the project better. We're willing to invest several million dollars, again, into trying to improve the technical aspects of the project and I think we can reduce that cost somewhat, but I don't know how much. I do know it's going to require tens of millions of dollars in work to do that.

The second way we're going to do that is try to pursue federal mechanisms that do help the economics. That's the gas treatment plant, investment tax credit and accelerated depreciation. The third would be other mechanisms similar to what we see coming from the state. And I point out that in my experience, when I'm in Washington that is an issue that keeps coming up. What is Alaska doing to positively make the project happen, too. So, what we're doing is we're building building-blocks here so that ultimately we're going to have a project that is a reasonably competitive project and we've got a

plan to do that and the state being part of that is part of that plan, yes sir.

REPRESENTATIVE DAVIES asked about his comment that the tax credit is useful only if you pay taxes and wondered to what extent that provides an incentive to make sure that the gas is marketed in the Lower 48. Was it his point that if gets stranded in Canada, taxes won't be paid on gas in the Lower 48.

MR. MARUSHACK replied:

The point I was trying to make is that even the tax mechanism itself, if it comes through, is not foolproof. You've got to assume you're in a taxpaying position, which we are currently a U.S. taxpayer and we expect to be a taxpayer. The only point I'm trying to make there is when people talk about a floor, that means that the market would pay no less than \$3.25. That's not correct. We're going to be higher than that and we're going to be lower than that. All we're talking about here is when you get a tax credit, that kicks in.

This is unique because other tax mechanisms like Section 29 and royalty relief, those are an absolute grant of credit that the government has provided. We're not asking for that. Actually, the number is just too big; the project is too big. We think on a national energy policy basis, that it makes sense to have something that takes away that risk. The ultimate beneficiary of low prices is the Lower 48 consumer. The only point I'm trying to make here is this particular mechanism has that; that's the way it works, but not anything having to do with the market. The gas has to land in the Lower 48, because it can't be accepted into Canada and we've understood that and designed that system from day one. There is no reason for the U.S. to do this if it doesn't land in the Lower 48 and some national energy policy question we've got to resolve here.

CHAIRMAN TORGERSON asked if their merger was complete with Conoco yet.

MR. MARUSHACK said it wasn't.

CHAIRMAN TORGERSON asked if there were rumblings among the Conoco Board that they're not in favor of price floors.

MR. MARUSHACK said he couldn't speak for Conoco, because they're

not one company. The Phillips Chairman is going to be the new senior executive of the new company and his view is that they need two pipelines. He has been clear with everyone that the tax mechanism is necessary and it needs to happen now.

CHAIRMAN TORGERSON said he didn't expect Conoco to oppose anything that they are working on.

MR. MARUSHACK replied that he did not.

MR. DAVE DINGELL, Manager, City of Valdez, said he was speaking today on behalf of the Port Authority. He didn't have any specific comments on the questions that were asked on the credit provisions or other incentives. Their economic model indicates that no federal or state legislation is needed to help their project. But if there are incentives, they should apply to any project and not be specific to a route such as the Alaska highway project.

REPRESENTATIVE GREEN said his program is predicated on a federal tax free project and asked if he didn't consider that an incentive.

MR. DINGELL replied that they have a letter from the IRS that says they are exempt from federal income tax.

REPRESENTATIVE GREEN said he had a little problem separating those.

MR. DINGELL reiterated if they were going to make recommendations to the next state legislature on any incentives, they should for any project that commercializes Alaska gas.

CHAIRMAN TORGERSON said he thought they were broad enough to cover anything, but he didn't think the federal taxation would ever get there again.

REPRESENTATIVE DAVIES said his understanding of the Port Authority project is that it's a Y-line.

MR. DINGELL said that is correct.

REPRESENTATIVE DAVIES asked if these credits were enacted, would his project be benefited.

MR. DINGELL replied that it would benefit a portion of one possible project.

REPRESENTATIVE DAVIES said he understood that they get the biggest benefit from the Y-line approach and that the LNG stand alone doesn't work. So, it seems unlikely that that would go first.

MR. DINGELL replied that at the present configuration, the Port Authority supports the Y-line concept, but they are looking at other options. "A lot of people look at the project as the main line is going through Canada and the spur is to tide water and it could be reversed."

CHAIRMAN TORGERSON said he had been number crunching and didn't know if a Y-line would be competitive with some of the cheaper gas that the companies are bringing into the Lower 48. He announced that they would next discuss the committee's two recommendations beginning with proposal 1, supporting the tax mechanism.

REPRESENTATIVE GREEN moved to adopt proposal 1.

CHAIRMAN TORGERSON said the justification for adopting proposal 1 was heard in today's testimony.

REPRESENTATIVE DAVIES said it should probably say the "tax credit mechanism" and specifically refer to the Alaska Natural Gas Pipeline Act of 2002 or H.R. 4.

MR. MARUSHACK recommended that they use a general term that would allow them the ability to accept things like a gas treatment facility investment tax credit and seven-year depreciation also to help improve the project on a federal basis.

CHAIRMAN TORGERSON suggested: "The Joint Committee on Natural Gas Pipelines supports the tax mechanism in Section 25.03 of H.R. 4 including provisions for accelerated depreciation and investment tax credits."

REPRESENTATIVE GREEN said he thought Mr. Marushack wanted the wording "such items as" inserted in front of accelerated depreciation.

REPRESENTATIVE GREEN said he wanted to withdraw his prior motion and start over again. There were no objections and it was so ordered.

REPRESENTATIVE GREEN moved proposal 2, that the Joint Natural Gas Pipelines Committee supports federal incentives to promote the timely construction of an Alaska natural gas pipeline such as...

CHAIRMAN TORGERSON announced an at-ease to write up proposal 2.

REPRESENTATIVE DAVIES read the proposal:

The Joint Committee on Natural Gas Pipelines supports federal tax mechanisms to promote construction of an Alaska natural gas pipeline such as the tax mechanisms in Section 25.03 of H.R. 4, accelerated depreciation and investment tax credits.

REPRESENTATIVE FATE suggested changing "to promote" to "that promote."

CHAIRMAN TORGERSON asked if there were any further questions or debate. There were none and it was adopted.

CHAIRMAN TORGERSON announced the second proposal to be up for discussion and said it supports the Senate version of the energy bill on the regulatory side of things. He explained that there was a gentlemen's agreement that there would be no amendments to it.

REPRESENTATIVE GREEN moved to adopt proposal 2.

REPRESENTATIVE DAVIES noted that they didn't necessarily support each individual one, but collectively as written, a compromise.

CHAIRMAN TORGERSON said he would like to add the word "regulatory" because that is what they are quizzing everyone on. He said there was an amendment to the second proposal so it would read, "The Joint Committee on Natural Gas Pipelines supports the regulatory provisions of the Alaska Pipeline Act without amendments."

There were no objections to the amendment to proposal 2. There were no objections to adopting proposal 2 and it was so ordered.

REPRESENTATIVE DAVIES said he thought they should advance the other items in the resolution.

CHAIRMAN TORGERSON said they could advance those in conversation with individuals with FERC or others, but if it requires an amendment, they have just said they will not advance anything that requires that.

He announced that they would take about an hour break and would then take up item 7, discussion of the lobby effort and item 8, a general discussion on recommendations.

1:15 p.m. - 2:38 p.m. - BREAK

TAPE 02-9, SIDE A

CHAIRMAN TORGERSON called the meeting back to order at 2:38 and

said that he would keep the committee appraised of what his travel plans are for going back to Washington D.C. and that they would work through C.J. Zane on the issues. He said the first trip back would be around September 9.

CHAIRMAN TORGERSON said that the recommendations were very preliminary. Mr. Dingell wanted these provisions to apply to oil projects and he thought they already did, but he has made a note to check that in final form. He asked the committee members to return their comments to him by September 20 so he could put it in packet form and maybe send it out for comments from the major players.

RECOMMENDATIONS

1. Continue banning the over-the-top route.
2. Before considering fiscal incentives, the legislature should require data from the producers.
3. The Legislature should consider the property tax, severance tax and others.
4. Have discussions with local governments about the ad valorem tax instead of "cramming it down their throats."
5. More cohesive communication between the Administration and the Legislature.
6. Look at the fiscal system.
7. Examine methods for state financial participation in the project.
8. Continue the committee's existence. There should be another resolution so that the interim work can continue. Hopefully, they are finished with Congress, but haven't started work with the Canadian government or First Nations in Canada.
9. Continue and expand the international committee to help work out some of the perceived regulatory problems crossing borders. He said they have put together a good team this year with Patrick Coughlin and others.
10. Continue to assess state needs and gas reserves
11. Provide more access for explorers.
12. Keep Alaska's royalty-in-kind in the same state it is in right now.
13. Provide access to communities.
14. Tie local consumption in with the Right-of-way Leasing Act.
15. Streamline permitting.
16. Include Alaska hire provisions
17. Provide training and labor in Alaska.

REPRESENTATIVE DAVIES asked if they should consider what will happen if the initiative passes.

CHAIRMAN TORGERSON said if they wait until after the election, they

would know what they are dealing with. He told members, "I envision a couple day meeting...if we're that serious about making recommendations to the next legislature."

CHAIRMAN TORGERSON adjourned the meeting at 2:55 p.m.