

**SENATE AND HOUSE  
JOINT JOURNAL SUPPLEMENT**

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**February 4, 2004**

**Wednesday**

**No. 12**

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**Update on the Status of Gas Applications**

**Under the Stranded Gas Act**

**by**

**The Honorable Frank H. Murkowski**

**Governor**

**State of Alaska**

**Before a Joint Session**

**of the**

**Second Session of the**

**Twenty-third Alaska State Legislature**

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**February 4, 2004**

**Juneau, Alaska**



**The following was submitted for publication:**

Thank you President Therriault and Speaker Kott for inviting me once again to address this second session of the 23<sup>rd</sup> Legislature. My purpose is to bring you up to date on the gasline.

I compliment you for the speed with which you passed the Stranded Gas Act last session. I appreciate your continuing enthusiastic support for this project.

Thanks to a number of actions by the Legislature last session, industry is taking a new look at investing in Alaska. We are seeing signs of renewed enthusiasm for doing business here.

As you know, the first element of our fiscal plan is to achieve a long-term solution with revenue from natural resource development — like the gasline, leasing in Bristol Bay, access roads, and the NPRA—to name a few.

We have made significant progress over the last several months in arranging to move Alaska's gas to market. I traveled to Houston, Washington, DC, New Orleans, Asia and elsewhere to find new opportunities to make the gasline a reality.

I was pleased to announce two weeks ago that the state received two Stranded Gas Act applications. One from sponsors including CIRI and the other 12 Alaska Native corporations, Pacific Star Energy, and MidAmerican, which is 80% owned by Warren Buffet's Berkshire Hathaway company. Another from the Alaska producers — ConocoPhillips, BP, and Exxon. This is delivering on my commitment to hasten resource development. Alaska is fortunate that either of these sponsor groups is exceptionally capable of successfully financing and taking on the complexities of the Alaska Gas Highway Project.

The receipt of these applications represents a "first" step in the right direction. It means that in the near future our gas will no longer be stranded. The interest of the producers in getting their gas to market has depended upon the market price of gas and their need to use the gas to maintain reservoir pressure to pump oil. Their interest in selling and MidAmerican's interest in moving the gas to market demonstrates

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that Alaska's gas is marketable. And, we will approach our responsibilities in recognition of this new reality.

There have been four previous attempts to bring Alaska's gas to market:

- Two efforts back in 1974, one over the top and one LNG project.
- Another in 1976 along the Alaska Highway with John MacMillen's Northwest Pipeline.
- And in 1992, the Yukon Pacific Corporation, lead by our own Governor Hickel, proposed an LNG project parallel to the TAPS route.

Each of these marketing proposals failed in the face of numerous challenges, including the facts that:

- Our gas is 800 miles to tidewater--or 1800 miles from the existing Canadian system in Alberta.
- Large and growing volumes of natural gas coming in from Canada. Gas availability at tidewater from Pacific Rim countries which did not have to amortize the cost of an 800-mile pipeline.
- Jones Act problems.
- And, extremely low gas prices in the Lower 48 and world markets.

Given this background, you may be asking yourself what makes this effort any different from its predecessors? Simply put, it is the combination of:

- Current high gas prices, which are projected to rise even higher.

- Reduced gas reserves in North America.
- And increasing demand in Canada and the Lower 48.

The conditions are favorable now (and far more advantageous for Alaska) than those with which any of the earlier commercialization efforts had to contend. But, these conditions will not exist forever. As foreign LNG makes its way into the North American market, the window for selling our gas will tighten.

A gas pipeline can readily deliver into the US domestic markets cheaper than imported LNG but, in any case, the transportation cost is simply passed on to the consumer. It is in this context that the State of Alaska enters into negotiations to establish our fiscal regime under the authorization of the Stranded Gas Act. It is time to get our work done.

As negotiations begin we must first consider what we want to achieve for our state and future generations of Alaskans.

You wisely legislated the Southern Route. While some have questioned it, I told the three producers last summer that this point is non-negotiable. And I reinforced it with my White House meetings. I have also directed our negotiating team to make sure that the Stranded Gas contract which we will propose to you meets the following goals:

See  
Chart  
#1

- 1) Open access to the pipeline for exploration companies. We want to encourage companies to come to Alaska to explore for gas. To do so they must be assured that they can get their gas to market. We are helping provide access with roads such as extending the North Slope spine road across the Colville River and to Nuiqsut, Bullen Point Road; and building an access road from Pump Station 2 on the Dalton Highway through the Northern foothills of the Brooks range, where there is interest in state oil and gas lease sales. The explorers need the road access and they also need open access to the pipeline.
- 2) Alaska participation – Alaskans should consider the opportunity to invest in the gas pipeline. In retrospect, Alaska may have been wise to have invested in the oil pipeline 30 years ago because it would have given Alaska a seat at the table with the producers and avoided costly litigation.

3) The opportunity for a spur line to Anchorage, the Kenai, and Valdez to expand and help the economics of the LNG project. We must have the ability to get gas to Kenai to protect our billion dollar petrochemical industry there. We need more gas for our consumers in Anchorage who face the loss of supply as Cook Inlet sources decline. And we need the opportunity to take gas from the line in Fairbanks and other communities for economic development opportunities there – such as gas liquids and Petro Chemical.

4) Hire Alaskans first.

5) Protect impacted communities and boroughs.

These are among the state’s priorities. From the companies’ point of view, there are five factors to consider in determining the viability of a gas pipeline delivery system. As illustrated on this chart they include:

See  
Chart  
#2

1) Wellhead price of gas – this will be determined based on the cost of constructing and operating the line, the tariff set by FERC and regulations. It is in the State’s interests to help keep costs down in order to increase the wellhead value of the State’s royalty gas.

2) State’s fiscal terms and conditions which will be negotiated under the Stranded Gas Act.

3) Federal fiscal terms and regulatory conditions. The Congressional Delegation is doing its utmost to attain the administrative and fiscal provisions of the Energy Bill. I will be working with the Bush Administration and the Delegation on this when I am in Washington, D.C. later this month.

4) Cost to construct and operate a pipeline system. The North Slope Basin is the most expensive on-shore basin in the world for exploration and development. To attract capital we must reduce costs to stay competitive.

5) And finally, the price the gas brings at market – which as we know is considerably higher today than it's been in recent years, is and still going up.

The complexity of the Stranded Gas Act dictates a detailed examination of the state's responsibilities.

My Stranded Gas Team is under the leadership of Bill Corbus, our commissioner of Revenue along with DNR Commissioner Tom Irwin and Attorney General Gregg Renkes. The team is assisted by internationally renowned expert Pedro VanMeurs and a very qualified technical staff from the Departments of Revenue, Natural Resources, and Law.

Keep in mind that the Stranded Gas Act does not compel the applicant to build the pipeline – it only assures fiscal terms - should the decision to build be made.

A proposed project plan must contain such things as a description of work accomplished to date, a schedule and description of proposed development activity, and a description of the leases thought to contain the stranded gas that would be developed. What can be negotiated?

- 1) The fiscal system governing gas – Taxes and Royalties.
- 2) Fiscal relief – Including payments in lieu of taxes and for royalty adjustments.
- 3) Access to the pipeline for other gas explorers.
- 4) Making gas available for in-state use.
- 5) Alaska hire, buy Alaska and build with Alaskans.

When a draft contract is acceptable to the commissioner of the Department of Revenue – he will develop preliminary findings and make a determination that the proposed contract terms are in the best interests of the state.

Public notice will be given and 30 days provided for the Legislature and the public to review and comment on the commissioner's preliminary findings and draft agreement. At the end of this comment period the commissioner of Revenue has the opportunity to amend the contract through additional negotiations with the applicant. When this process is completed I will be in a position to submit the contract to you for your approval.

There are components of the process worth noting here:

- Confidentiality of the applicants - proprietary information used by the state in its deliberations is protected under the statute.
- The Act authorizes the Department of Revenue to receive up to \$1.5 million from the applicant to hire outside experts to assist in evaluating contract terms.
- The Act calls for a municipal advisory board to be formed from those local government entities that are impacted and economically affected by the pipeline project.
- This advisory board will provide input to the Stranded Gas negotiating team. I am pleased to report that the Department of Revenue has already begun the establishment of this advisory group.

As you can see, this is a robust and complex process. That said, it is my sincere hope that I can place a contract before this body before the end of this session.

I understand that the issues we contemplate in this effort are extremely serious and have sweeping ramifications on Alaska's future. You have my pledge to pace this process in such a way as to make sure the state's interests are fully protected. We will move quickly, but we will act smartly, and as they say, the devil is in the details.

I also commit to you that I will give you a document early enough in the session that you have an appropriate amount of time to evaluate its content. With a balance of caution and optimism in mind – I feel

confident in saying that what we do here in the upcoming months could significantly contribute to the next chapter of Alaska's economic history and help secure its long-term fiscal future.

I pledge to you and to Alaska's people that I will do all in my power to achieve construction of the gasline, along with other economic development projects, in order to provide new sources of revenue to the state. And I will consult regularly with your Leadership and keep you fully informed of our progress as negotiations continue.

Now, let me connect the dots between the opportunities this project brings and the state's current financial situation.

While North Slope revenues are projected to continue to decline over the next two decades, a number of new revenue sources are anticipated. They include from top-down, Bristol Bay/Alaska Peninsula, natural gas pipeline, ANWR, Beaufort Sea, Central North Slope and the NPRA.

As you can see from the chart, the state can expect to receive substantial increased revenue from new economic development sometime between 2010-2013.

See  
Chart  
#3

That leaves us a cumulative gap estimated at \$4.3 billion over the next seven years – until new revenues from resource development significantly kick in – projected to start in 2011 with \$500 million and 2012 with \$950 million. We need to bridge between our immediate fiscal situation and the time when economic development generates new revenue for the state. We must be able to maintain essential public services in the mean time. We could even sunset such bridge financing when gasline revenues come in.

As you know, I have asked the Conference of Alaskans to be held in Fairbanks February 10-12 to assist by answering four questions surrounding potential use of a portion of the income from the Permanent Fund to maintain essential public services.

I do not know what consensus the Conference will achieve. In the event they propose using the endowment mechanism to maintain essential public services, after paying dividends and inflation proofing

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the Fund, I will be submitting such a proposal to you to put on the November ballot.

The inevitable consequences of not dealing now with the depletion of the Constitutional Budget Reserve, which will drop below one billion dollars in the 2006 timeframe, is all too apparent. The POMV solution and process identified gives Alaskans the opportunity to vote on the question this fall if you put it on the general election ballot.

Those who oppose using a portion of the Permanent Fund income to pay for essential public services have a responsibility to step forward with an alternative solution that Alaskans will accept.

This time there is no dodging the fiscal bullet. Our constituents rightly expect us to achieve a solution and it would be an abrogation of our sworn oaths, if we were to ignore our duty.

I compliment all of you on our efforts to cut state spending. We are among only a handful of states to achieve spending reductions while experiencing declining revenues. Our cities, our communities, our school districts are following suit. And it is tough.

We will continue our efforts to reduce government, but the time has come with the decline in the budget reserve, to identify a substantial revenue source and move on with the other challenges before us.

I have laid out before you a process and a solution. The rest is up to us. As Abraham Lincoln said, "You cannot escape the responsibility of tomorrow by evading it today."

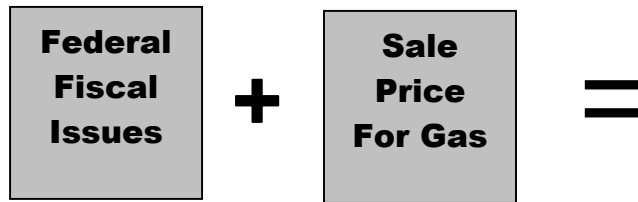
**Please report corrections to the Senate Secretary's office.**

Chart #1



Chart #2

# Gasline Decision Matrix



**Build or No Build**

**Chart #3**

