

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

March 31, 2004

3:35 p.m.

TAPE(S) 04-33, 34

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Fred Dyson
Senator Ralph Seekins
Senator Ben Stevens
Senator Kim Elton
Senator Georgianna Lincoln

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Gretchen Guess
Senator Con Bunde
Representative Beth Kerttula
Representative Eric Croft
Representative Ethan Berkowitz

COMMITTEE CALENDAR

CS FOR HOUSE JOINT RESOLUTION NO. 34(FSH)
Requesting the United States Department of Agriculture and the United States Department of Labor to extend Trade Adjustment Assistance benefits to Alaska salmon fishermen; requesting the United States Congress and the United States Department of Agriculture to extend additional disaster and price support benefits to Alaska salmon fishermen; and requesting the United States Department of Commerce to establish a Trade Adjustment Assistance program specific to commercial fishermen.

BILL POSTPONED TO 4/2/04

Alaska Stranded Gas Applications

Mr. Kirk Morgan, Vice President and Project Manager, Alaska Gas Transmission Company (AGTC), MidAmerican Energy Holding Co.

Mr. Joseph P. Marushack, Vice President, ANS Gas Development, ConocoPhillips Alaska, Inc. - representing the producers

Ken Konrad, Senior Vice President, Business Unit Leader, BP Exploration (Alaska), Inc.

Mr. Mark Hanley, Manager for Public Affairs, Anadarko Petroleum

ACTION NARRATIVE

TAPE 04-33, SIDE A

CHAIR SCOTT OGAN called the Senate Resources Standing Committee meeting to order at 3:35 p.m. Present were Senators Ralph Seekins, Thomas Wagoner, Fred Dyson, Kim Elton, Georgianna Lincoln and Chair Scott Ogan. Senator Ben Stevens arrived at 3:40 p.m. Chair Ogan announced that Mr. Morgan, AGTC, Mr. Marushack representing the producers, and Mr. Hanley, Anadarko, would speak before the committee and stated:

^ALASKA STRANDED GAS ACT APPLICATIONS

The purpose is not to Monday-morning-quarter-back the events of last week, but to be more forward looking on where we're going, not where we've been and to try - I think it's imperative upon the Legislature to consider whether or not we should make a policy call on what's in the best interests of the state - whether it's to have a producer owned and operated pipeline or an independently owned and operated pipeline and what do both groups bring to the table - the pluses and minuses and advantages and disadvantages....

MR. KIRK MORGAN, Vice President and Project Manager, Alaska Gas Transmission Company, thanked the chair and committee for inviting him to share his views on the proposed Alaska gas pipeline project and AGTC's Stranded Gas Development Act application. He stated that he is a former employee of Northwest Alaskan Pipeline and, in the early 1980s, coordinated all the field programs and acquired the estimated 4,000 permits to execute the project. After it was suspended in late '82, he continued to work with Northwest Energy Company, which was acquired by the Williams Companies. Since then, attempts have been made to restart the project and reconstitute the old Alaska

Northwest Natural Gas Transportation Partnership. Most recently, an attempt was made in 2001, but the attempt was not successful.

Today, he is back as a result of some of Williams' assets being acquired by MidAmerican Energy Company. MidAmerican believes that there is a growing supply/demand imbalance in the Lower 48 states from new power generation, general economic growth and conversions to natural gas (relating to the Clean Air Act). New development, like the Alberta Oil Sands, requires an immense amount of gas to produce, for instance. At the same time, the Lower 48 supply basins, except the Rocky Mountain basin, have been declining.

Even the western Canadian sedimentary basin, which really fueled the growth of the Lower 48 for the last one or two decades is now in decline. The initial discoveries are smaller; the drilling costs are higher and the decline rates have increased, as well. So, although you have record amounts of drilling that occur in western Canada, they're just barely able, in fact, they are not able to keep up with production and certainly not able to keep up with the export volumes to the Lower 48.

Predictably then, you see higher gas prices, substantially higher gas prices. They've doubled in a couple of years and that's contributing to at least a level of demand destruction in the chemical areas - in the aluminum manufacturing, in fertilizer businesses and that's certainly not healthy for the U.S. economy. So, the market has recognized that and there are now, since the famous Greenspan proclamation, there are now more than 40 proposed liquefied natural gas import terminals in the U.S. and Mexico that together represent more than 30 BCF of potential new supply that would come to the U.S. That is really what drives our belief that the timing for the Alaska natural gas pipeline is critical - it's important and it is now.

Most of those LNG terminals do not propose to be in service until, perhaps, 2008 or 2009. Those are probably optimistic schedules, but it's important that if Alaska gas is to be commercialized, it be competitive with the LNG resources that are being proposed to come to the United States. Alaska gas is widely viewed by most people that forecast gas to be over the horizon, to be something in the 2016 or 2018

time period. Our view at Alaska Gas and MidAmerican is that that schedule needs to be accelerated and that Alaska gas should compete head on head with the proposed LNG import terminals.

The project, however, has started and stopped a number of times and it really suffers from a lack of credibility. We have believed since we came up to Alaska that Alaska really needs a development partner that will be fully aligned with the interests of the State of Alaska and will actively push this project forward to an early in-service date, which we proposed to be December 2010. So, that alignment is very important and in terms of what are the state's interests, we feel like independent ownership of the gas pipeline is in the state's interests.

We think that market structure matters and it matters a lot. We have extensive experience in California - and what you saw there contributing to an energy crisis was a broken market structure. Hopefully, we've learned some lessons from California about market concentration and market power and transparent markets and we think that an independently owned pipeline will enable functional gas markets to occur.

Our proposal is to utilize existing down stream pipelines so that we can access diverse markets across Canada and the United States. It's a fundamental difference between our proposal and a bullet line to the Chicago area. We think that having greater market access does a couple of things. It allows there to be more shippers on the pipeline whether they're LDC shippers, whether they're electric generators - large industrials, whether they're marketers. If you have a broader market reach, you can have more market players, more shippers on the pipeline. That, in turn, enables us to spread the risk of holding pipeline capacity.

It occurs to us that if the producer group owns the gas, they own the pipelines. Just Monday, natural gas intelligence released the top North American gas marketers and between the three North Slope producers, they market 40 percent of the gas in North America. To us, that seems like an invitation for excess market

concentration and market power and we think an independent pipeline is in the interest of the state.

The other significant interest is to accelerate the development of the project. We've proposed an in-service date that is fully five years before you might expect a gas pipeline to be developed by the producer group. That's for a number of reasons. We believe that the producer group has other interests around the globe - both in LNG imports and McKenzie gas and that they have to work out where to deploy the capital necessary and in what order to bring Alaska gas to market. From an independent pipeline perspective, we have no interest other than to bring the gas to market as quickly as possible at the most competitive rate to commercialize the project. The meeting we had last Monday with the governor, I think the producers outlined a number of prerequisites to development and they included getting a federal energy bill, getting a Stranded Gas Development Act contract, getting a favorable Canadian regulatory regime, which would enable somebody to build a pipeline outside of the Northern Pipeline Act, which conveys exclusive rights to TransCanada and they indicated they needed to pursue lower costs. The proposal is a one step at a time proposal that would result in the project being in service some time in the 2015, 2016, 2017 time frame. We feel, as I've mentioned, that we could do substantially better than that in accelerating the timing of the project.

Alaska ownership in the pipeline is another desire that's been expressed to us and when we came to Alaska, we took that advice and we went out and developed a partnership that does have a 19.9 percent Alaska Native corporation ownership. So, we think that's also an important distinction.

We feel like we are very well aligned with the interests of the State of Alaska and that this is a very large, complex project. It has many development components; it will require a lot of money and time to develop the project. But, the marketplace needs to receive this project as serious and we've asked the State of Alaska to make a serious commitment. We've asked to be their sole development partner. That may mean different things to different people, but we've

looked at potentially investing \$100 million over the next two years to advance this project and what we don't want to have happen is for the state to turn around and start providing incentives to other parties, whether they be SDA contracts, whether they be shipping commitments or other commercial ways to support a competing project. If we have put that money at risk and successfully developed a project, we feel like we should be the ones who are allowed to build and operate that project.

Having said that, there has been a tendency for everybody to jump to the final answer. What is it going to take to commercialize the project? And quite simply, that is not knowable at this time. We didn't come to Alaska with a fully baked project ready to go. It will take three years worth of development work to develop a commercial proposal. Our concept is to develop the lowest cost tariff to market by number one, avoiding construction of a new bullet line to Chicago, for starters. That will drop about \$5 billion off the capital expenditure for the project, but also, by utilizing these existing downstream pipelines, you create more efficiency. You drive 4.5 BCF of gas on the pipelines that have existing available capacity. By increasing the throughput on those pipelines, the unit cost or the cost per decatherm can be reduced and we think that's an important component to saving costs.

The integrated system approach is also more expedient, because you don't have to build another 1,500 to 1,600 miles of pipe; you don't have to get into a legal challenge with the Canadians over exclusivity on the Canadian part of the line. The integrated approach, again, as I mentioned earlier, will access more diverse markets. Rather than just dropping gas off in Chicago, it will serve the West Coast, the mid-Continent, the East Coast, the Canadian markets throughout the Pacific Northwest. That's important, because when you bring in 4.5 BCF of new supply, there is going to be a market response. If you deliver that all to one market, that price response will be more dramatic - it will lower the prices dramatically. By making that gas and delivering it throughout the U.S., we feel like the price response will be less dramatic

and that's important to maintaining the highest possible netback at the wellhead.

We have proposed a project plan for the next two years and that involves validating the construction costs. There's been a lot of work done on this project, but we are aligned primarily on work done by TransCanada over the last couple of decades. The most recent cost estimates that we have are 2002. There's a lot of things that have changed since then - the dollar has declined significantly. A lot of the pipe and steel plate compressors could be purchased overseas for this type of project equipment and we need to assess the impact of that. We need to assess what's happened in just the last quarter with steel prices. We need to know that the capital costs that we've proposed are valid and that is something that we plan to undertake this year.

There is also a wide range of environmental and engineering studies that have to be performed so that we have confidence in the number and that when we go to commercialization, the market is not just signing up on, you know, maybe it's close to \$6.3 billion - we have to know that. We intend to put in tariff provisions that include capital discipline so that there are rewards or penalties for missing that number. So, it's a very important number to us.

There's also a lot of environmental work that is done that is necessary to support the FERC filing. In our case, that was proposed after two field seasons or some time after had we gotten started on time. Some time after the 2005 field season we'd be filing with FERC. They require about 18 months to process that and that would allow us to get a financial close and a final certificate for the project in the first quarter of 2007.

There are a lot of other elements as far as negotiating agreements in Canada to make sure this is a seamless project all the way from Prudhoe Bay to market and we have to lock down a lot of variables. We need to lock down what the tax regime will be; we need to lock down what the financing costs would be. We have been discussing the possibility of getting tax exempt financing either through the Alaska Railroad

Corporation [ARRC] or other entities to combine with the loan guarantees that we hope will be included as either part of the energy bill or a separate rider.

The cost of capital is something that is very important. Interest rates are very important to the ultimate tariff and when you hear us being criticized for not offering a proposal, it's because there are a lot of variables that we want to lock down and make sure that we have base case models with assumptions in them, but we need to validate all of that.

We also need to validate the downstream tariffs. When you talk about an approach that utilizes the existing infrastructure that's there, that's many pipes and there should be incentives offered by those pipes to drive this kind of new volume on to the project. There are things like identifying operating costs and project labor agreements, in negotiating shipping contracts and helping to facilitate the gas supply requirements. It's a lot of work; there's a lot of risk; there's a lot of variables and that's what we were proposing to do in our project plan.

There's also the market side, knowing that the cost of gas plus the tariff, the cost to move the gas, will clear the market. Predicting gas prices is certainly something that doesn't have a consensus and the project needs to be economic in a wide range of assumptions. Some of the things that are critical to assessing the predictive modeling that we've been doing are a variety of demand growth scenarios, various levels of market penetration by the LNGs. Certainly, not all 40 are going to be built; some amount will.

But, what happens if 5 BCF or 10 BCF is built? What does that do to market pricing overall? What does the decline in domestic production do to price? The 13,000 wells that are drilled in Canada every year have a decline rate of between 22 and 25 percent. When the Alaska gas line becomes a certainty, what will that do to those drillers' allocation of capital? Will they quit drilling? Once the pipeline is built, that gas will flow and if producers stop drilling or reduce drilling when we begin construction, there will be a large decline in the volumes available for western

Canada. So, we have to assess that and generally assess the impact on prices that this large volume of gas will have. So, that is part of the development effort, as well. It's a long-term development process and it involves significant expenditures. So, where we came to in all of that is really there are two principles that are important - the policy issues that have to be dealt with by the state and the first one is an independently owned pipeline in the state's best interest. We feel very strongly, for the reasons I have stated, that it is. We can accelerate the construction schedule. We will limit the amount of market concentration or market power that is held by a new party and the number of shippers that we envision getting in our marketing plan will allow the risk to be spread of holding that capacity and allow for gas markets to function more properly.

The second question is the period of exclusivity that we have asked the state for. We've called it by different names; we've probably made a mistake using that word, but we want to be the state's sole development partner. We don't want them to be assisting in any meaningful manner competing projects and that's because the costs to do this development are so high and the risks are so high, as well.

Exclusivity is not new. The ANGDA [Alaska Natural Gas Development Authority] partnership granted exclusivity to the ANGTS [Alaska Natural Gas Transportation System] partnership; TransCanada has exclusivity on the Canadian part. That exclusivity has given those partners the comfort that was required to spend the \$400 million in Alaska that was spent in the early 80s. So, it is not a new concept and we think that if you want the project to be accelerated, it's essential to us to have some level of protection for our investment.

Unfortunately, that's where our negotiations have broken down. As you know, we've withdrawn our Stranded Gas Act [SGA] application. We made it clear that that investment protection and exclusivity was crucial to us moving forward. We are now on the sidelines, but we do continue to believe that the project is essential, both for the Lower 48 and for Alaska. We believe that the timing is critical, that it needs to be initiated

now, that it needs to be taken seriously in the marketplace. And, if there is a path forward that involves Alaska Gas Transmission and MidAmerican Energy, we'd be willing to listen to what that path forward is. Unfortunately, we're unable to get there with the state at this time. That concludes my opening remarks. I'd be happy to invite your questions now or after the other presenters.

CHAIR OGAN noted that all committee members were in attendance, as well as Representative Eric Croft and Senator Gretchen Guess. He stated that commercializing the state's gas is one of the Legislature's biggest priorities. As chair of the Energy Council, he has found one of its dominant discussions confirms that both market and price are there.

So, the timing is very good. I think we, as a state, need to make a statement and maybe it's the Legislature that makes the statement, that I believe we appear dysfunctional to the market and to investors.... And it's time that we have some leadership and give some clear direction....

SENATOR KIM ELTON asked what is a reasonable timeline for establishing an appropriate tariff level.

MR. MORGAN replied:

There are representative tariffs today. I think there's been a proposal submitted to the state that shows a tariff from Prudhoe Bay to Alberta Hub of \$1.10. That's what we need to validate. We certainly have replicated that rate model. We don't have any reason to believe that rate model is inappropriate, but there are a lot of assumptions in a rate model. Billing determinants are one and that's one difference between our proposals. We're proposing initially a 4.5 BCF per day project compared to a 4 BCF project. Generally speaking, you get economies of scale out of increasing the size of the project in that you would expect to have lower unit costs - all things being equal.

The financing, as I've mentioned, is extraordinarily important. On the project that we just completed at Kern River we lowered rates by 11.4 percent on the first day of operation because of successful

financing. We were able to close financing on almost \$1 billion of debt at 4.89 percent - compared to the 7 percent we had projected in our tariff. All those benefits are straight pass through; there's no benefit to the company other than it makes a much more competitive pipeline and that's always to the benefit of the company.

What interest rates are going to be when we get the financing? We won't know until we have daylight on the two issues - the loan guarantees and the possibility of tax exempt financing. But, what is in the model is 7 percent interest rates and there's an ability to do better than that.

On other things like taxes, we were engaged in the Stranded Gas Act negotiation - that's another large component, operating costs are a large component, capital structure and return on equity. When we get to a point of sitting down to negotiate with shippers to see what the tariff will take to clear the market and how the risks of holding capacity should be allocated, it's not just necessarily a low tariff, it may be a friendly tariff. It might be occasionally there are excess volumes that could be transported and who gets the revenue off of that. We've got revenue-crediting mechanisms on other pipes. There are a number of issues. It would probably be when we file with the FERC [Federal Energy Regulatory Commission] - we'll have a proposed tariff there. That was planned to be in the beginning of the fourth quarter 2005, but we need to have two full field seasons before we can be in a position to make the environmental and engineering representations in the FERC filing. What is occurring here is we are standing a very high chance of losing the 2004 field season and all of the dates would progressively move back.

SENATOR FRED DYSON said the McKenzie Delta pipeline is estimated to bring 1 BCF to market and some think that "will get soaked up in the tar sands." British Columbia thinks it is going to be a major gas producer and he enjoyed Mr. Morgan's comments on how the Canadian producers will affect the market.

MR. MORGAN responded that the oil sands in eastern Alberta is a big market and maybe McKenzie gas would get "soaked up there." Maybe the project will need more gas.

It probably depends on the price of oil and how aggressively the tar sands are developed there. The other Canadian market is really power generation. Except for a small amount of renewables, most of the base power generation is gas fired these days. But, as a practical matter, most of the gas we anticipate, Canadians will supply themselves, and most of the gas will be marketed in the Lower 48. But, we do see a decline in the amount of export capacity that will be available from Canada to the Lower 48.

SENATOR THOMAS WAGONER noted that MidAmerican had asked for a five-year exclusive contract and asked how a spur line off the main line going into the Cook Inlet Basin played into that request.

MR. MORGAN replied:

As I mentioned, we probably made a mistake using the exclusive word and not defining what that meant, but we have been clear with the administration all along that the exclusivity provisions that we sought were with regard to a Prudhoe Bay to the Yukon border pipeline. We have no interest in seeing the efforts of the Port Authority or ANGDA get derailed. Frankly, there's nothing that we're doing with the Alaska pipeline that would in any way disturb the plans of those two projects. Exclusivity did not apply to in-state uses at all. It was for the line from Prudhoe Bay to the Yukon border.

SENATOR WAGONER asked how knowing the state has first call on the 12.5 percent of their royalty tied into demand for gas in the pipeline.

MR. MORGAN replied:

We met with the Port Authority and understand their plans. It's that the Alaska Highway Gas Pipeline was big enough by itself to take on without trying to make it bigger; and so we've solely focused on that. But, we've also assured the Port Authority that there's nothing we were doing that would in any way conflict with their ability to tie into the pipeline at Delta and bring gas to Valdez, to Anchorage, to Kenai, wherever it needed to go to. It is an open-access

pipeline. It is FERC regulated. We provide both receipts and deliveries to anybody who wants it on a non-discriminatory basis. So, we don't actually know until we hold what's called an open season where the market will be. But, if the Port Authority were to take a B or a B and a half of gas, that would fundamentally change the design of the pipeline. You want to keep the economies of scale the same on the Canadian end. So, it might be that we're looking at an immediate expansion case to expand the Alaska end of the pipeline to accommodate the Port Authority.

CHAIR OGAN said an independent only makes money on the tariff and asked him what would stop him from trying to build as much profit as possible into the tariff.

MR. MORGAN replied:

Well, the project has to be competitive. We make zero if we can't commercialize the project and so our interest is in getting the lowest-cost commercially viable tariff so that it will aide in getting shippers to take capacity on the pipeline. The tariff will be set by FERC who is charged with insuring that there are just and reasonable rates. But, you know, if we fully develop the project and somebody came in and says we'll do it for 1 percent less on return on equity, that would be unfair to the developer, in our view. We would set out from the beginning what our rate assumptions are and the state or the shippers - anybody is free to intervene at FERC - and say you guys are making too much money. But, I don't think we are or we're not proposing to. We're looking for a very low-cost commercially viable project.

CHAIR OGAN asked if FERC adjudicates the tariff of this pipeline, would it be set by agreement or by FERC.

MR. MORGAN replied:

There [are] generally two types of rates. One is a recourse rate, which is set by FERC and approved and it has rate design principles in it and it's available to any customer on a non-discriminatory basis. There could also be negotiated rates, so that we sit down, whether it's with the State of Alaska or with an LDC [local distribution company], with a large electric

generator or industrial customers or the producers. The FERC allows for parties to sit down and negotiate a rate. Those rates are then, at least the recourse rates, are subject to periodic review by the FERC to insure that they are just and reasonable.

SENATOR GEORGIANNA LINCOLN asked what in his negotiations with the state led him to believe that a little more time for review of his proposal by his company and the state wasn't needed to go forward. "Also, when you speak about being on the sidelines, does that mean that you would be willing to come back into the project, if the two negotiators can come back together again?"

MR. MORGAN replied:

The process that we started with was not the Stranded Gas Act application. We filed a development proposal with the state - a joint development proposal - back in December - asking us to actually be partners - to share development costs - for the state to be an equity owner in the pipeline. That was not possible because the state didn't have funds appropriated through the Legislature and felt like maybe it didn't need to be in the developer role. So, we amended our proposal to say, well, we will bear the risk of all the development, if at the end of the day, if we're successful, we get to build it. That proposal has been on the table for four months and it's a pretty basic policy decision to make. And, when we sat down and initially went through a work plan, at the governor's request, to complete a Stranded Gas Contract, both sides agreed to a work plan and to dates. I think you can see in the series of press releases that it was the intention of all parties to get a contract in front of the Legislature this legislative session. And that's the schedule we all committed to and we've been working on.

As regards to your last question about being on the sidelines - it's simply because we've withdrawn our application. But, if it can be shown that there is a structure on the deal that will achieve the protection of our investment dollars, we'd be willing to listen to that. We haven't been able to get there at this time.

CHAIR OGAN noted that Senator Con Bunde and Representative Bruce Weyhrauch had joined the committee.

SENATOR RALPH SEEKINS asked Mr. Morgan how a small independent might benefit from independent ownership versus producer ownership of the pipeline.

MR. MORGAN replied:

As I said, we are an open-access pipeline or would be an open-access pipeline, which means we would accept gas from any party who is willing to sign a shipping contract on a non-discriminatory basis. I think being independent is really - that's our primary business - just moving gas. Our view is, if you had a producer-controlled pipeline, there may be inherent conflicts. Do they move their gas? Do they move somebody else's gas? Maybe there's competitive issues there. I don't know. But, by getting a large number of shippers, I think David Sokol has used the number 30, shippers on there - a mix of shippers, of producers, perhaps the state, LDCs, power generation companies, industrial users, you have a much more functional market, an active market, a transparent market - rather than having a few shippers that control all of the capacity. You know, perhaps regulations should make it work, even if it is a producer pipeline, but I think we've all learned that regulation is imperfect and there are instances where abuses and conflicts can arise.

SENATOR ELTON said that MidAmerican's original proposal envisioned the state as an equity partner in the pipeline and TransCanada had suggested the state share some risk by being a gas owner.

We can easily define exclusivity - your ability for five years to not have competitors - we can define that as the state sharing some of the risk. I mean, do you envision that the state needs to assume some risk beyond giving a company five years exclusive right to construct a pipeline, such as taking equity in the project or buying gas?

MR. MORGAN replied:

The TransCanada proposal was that the state take the full shipping risk, 4.5 BCF a day. If that happened, the project is commercialized overnight and there would be no need for exclusivity. We'd simply sign a shipping contract and the project would move forward. That would be the best of all worlds from a pipeline standpoint. However, we did not sense that the state was up to making that large of a commitment and our concept was to bring in more shippers from the marketplace, from the producers. We would very much welcome and encourage the state to take a capacity position. And as David Sokol has said, we'd consider at the appropriate time taking a capacity position ourselves, not as Alaska Gas Transmission, but as an affiliate of Berkshire Hathaway.

And so, our original view was that if TransCanada and Alaska Gas Transmission and the state were all in perfect alignment and willing to share some risks and make some commitments, we could send a very strong message to the marketplace that the project was serious, credible and being advanced very deliberately on a very deliberate schedule and that would jump-start the project and help others - whether they be LDCs or marketers or whatever - to join in that process and bring the project to an early commercialization. So, I do think the state should take some risk - whether it's just in the amount of their royalty position, which has been discussed, or in some larger amount, which would enable it to offer immediate capacity to an explorer, for instance. If an explorer came on and the pipeline were full, the state could simply release part of its capacity to that new person or that new explorer would have to wait until we could expand the pipeline. But, having capacity would give them that ability to make it available on an immediate basis.

CHAIR OGAN jested, "How do you break Ogan's golden gas rule - that if the guys with the gas make the rule, how do you get them to come to the table?"

MR. MORGAN countered, "Those are questions for another speaker, I'm afraid. For us it's getting an economic gas tariff. That's what the pipeline can do." [END OF SIDE A]

TAPE 04-33, SIDE B

4:22 p.m.

MR. MORGAN continued saying that over the years, the producers have said they didn't want the entire risk of the pipeline to be on their back and needed a value proposition for someone else to build it besides themselves:

That's what we're trying to offer here. Certainly, they have access to capital at low cost. We think we can duplicate that cost of capital through loan guarantees, through the strength of Berkshire and MidAmerican Energy and through tax-exempt financing. So, that wouldn't be an issue. We think we have the expertise, as do they, to bring additional market participants to the table to take and share some of the shipper risk by holding capacity. We think the state has a role in that and, as we've said, Berkshire would also consider that. Those are the elements. We expect to have to earn the business and provide a low cost tariff so that they will ship and get a reasonable netback for their gas. That's what we've set out to do.

CHAIR OGAN thanked Mr. Morgan very much for being at the meeting today and extended his thanks to Mr. Sokol for his cooperation. He announced that Representatives Ethan Berkowitz, Beth Kerttula and Mike Chenault had joined the committee. He introduced the next speaker, Joe Marushack, Vice President, ANS Gas Development, ConocoPhillips Alaska, Inc., who would represent the producers, saying, "We've been sitting across the table on this issue for many years. Joe, it's time we get past the talking part."

MR. JOE MARUSHACK, Vice President, ANS Gas Development, ConocoPhillips Alaska, Inc., vowed, "Well, we're trying to, Senator." He thanked the committee for allowing him to address this issue and noted that Ken Conrad, Vice President, BP, was on teleconference. He began:

I think the response to this question really has four important components. First, the only successful project will be one that has the lowest cost of service to market. Whether a pipeline company is affiliated or unaffiliated with the gas shippers, producers, or others, is really not as critical as

getting the project developed. And in this regard, what matters most is how much it costs to transport gas to market. The lowest cost solution advances the state's best interest, because it will provide the greatest royalty value. It provides the greatest tax base; it provides the greatest incentive for exploration.

From a producer's standpoint, the lowest cost of service project will maximize the value of the resource and, as the major explorer investor in the state, we need a cost of service that's low enough to encourage exploration - exploration for us, exploration for other companies.

One needs to consider the question - who is most interested in developing the lowest cost transportation system and who wants to see the lowest cost tolled. The answer - the producers and the state want the lowest toll, because it means higher netbacks and higher revenues. A pipeline company does not necessarily share that incentive, because its profits come solely from the toll and the greater the investment, the larger the return. But, the impact to the producers and the state is a smaller netback.

Second, it's much too early for any one pipeline project or project sponsor to be committed on an exclusive basis. The state needs to know which project will maximize the value of the state's resources. This needs to be an informed choice. We can't imagine that after so much interest in developing the state's gas resources, that the state would wish to sideline any party from developing a project.

One of the key factors we continue to pursue in Washington is the enabling legislation. That legislation would provide a clear regulatory process for the pipeline and care has been taken to craft this legislation so that any project sponsor, not just producers, could use it as a framework for a pipeline project. Additionally, we specifically request the state, that any pipeline specific terms negotiated under the Stranded Gas Act be fully assignable to any party, including independent pipeline companies to allow for the widest participation possible.

The third issue is the extent to which ownership affects access to and management of the pipeline. Again, whether the pipeline company is affiliated or unaffiliated with the gas owners is not the critical issue. The pipeline will be regulated by FERC regardless of who owns it. FERC will insure that access is fair and that terms and conditions are consistent, regardless of the sponsor, and the rates of return to pipeline owners are reasonable. FERC insures that the pipeline owners do not discriminate in providing access or administering expansions. This is an important point.

The producer pipeline proposal envisions transporting 50 TCF of gas over the project life. Currently, only about 35 TCF of gas has been discovered on the Slope. Thus, our proposal is dependent on additional gas being discovered and access to the line being made. There [would be] no procedural differences between producer-owned pipeline and an independent owned pipeline. Under any case, the pipeline would be open access regulated by the NEB, the National Energy Board of Canada, and FERC. Open access means any party can purchase pipeline capacity without discrimination. This may include, but not be limited to producers, local distribution companies, utilities, gas marketers, explorers, the state or even speculators. All that's needed is credit worthiness and a promise to pay for the capacity. FERC and NEB processes for securing capacity have been in place for several years. In addition, FERC in November 2003 issued a new regulation, which establishes a code of conduct governing activities between FERC regulated pipelines and all other energy affiliates. This [indisc.] regulation requires that firewalls be established between pipeline personnel and their energy affiliates, including producing affiliates and marketing affiliates. These rules recognize that pipeline operators may have affiliates that operate in segments of the energy industry and are designed to insure pipelines operate impartially.

Any mandate of ownership requirements at this stage does not make the project more likely, rather it threatens project viability. Indeed, FERC encourages competing pipeline proposals. FERC views this as helpful in developing a project that meets the

obligations to protect the nation's interests. FERC recognizes that limiting project sponsors from competing may result in a poor project or even no project at all. A recent example is competing projects pipeline projects have been proposed to transport [gasified] LNG from the Bahamas to Florida. FERC has approved both projects relying on market forces to determine which project proceeds.

Fourth, and by no means last, is the question of allocation of risk. As explained, the producers are aligned with the state in ensuring the most efficient and lowest cost of service. Independent pipeline owners who do not have a stake in other parts of the value chain earn profits solely from the toll. Mortgage investors assume cost risk or simply pass on risk to the state and producers. There's the potential for a lack of alignment that can further jeopardize the project. This is because neither the state nor the shippers would be in a position to manage or limit cost overruns, yet we would remain liable for the overruns through the pipeline rates. While there might be an opportunity to challenge the prudence of the pipeline's actions, the burden of proof is on the challenger. This issue must be considered in the overall context of developing a viable pipeline project. So, in short, we believe that the best interests of the state, the producers and the natural gas consumers, is that the process for developing a pipeline project be allowed to run its course under the terms of the Stranded Gas Act without any grant of exclusivity. As legislators looking out for the state's interests, we suggest the key considerations are which project has the lowest cost to market, insures open access, and includes risk-sharing, which supports project viability.

Just a couple other comments on some areas I'd like to get clarified a bit. There is a question about when this project can be done and I've heard 2016/18 is the producers' number. I'd ask you to go to the 2003 NPC, National Petroleum Council, study that was done for Secretary Abram that addressed supply and demand issues. In that, you'll see that Alaska gas is assumed to come on in 2014. The people who worked that process under the NPC were ExxonMobil, BP, ConocoPhillips, as well as others. So, I would point out to you that I

think the producers' view, the mid-2013, 14, 15 is when we hope that this project can come on line, not 2016/18.

Furthermore, the question about can people invest before without exclusivity. I'd like you to recall something. ConocoPhillips, at the time Phillips, BP and ExxonMobil spent \$125 million about two years ago developing the feasibility study that resulted in this project assumption of roughly \$20 billion-to-market, 2.3 BCF-a-day pipeline. We did not have exclusivity; we did not have any way of recouping that; we invested that just as we looked at developing other projects. And we think putting that at risk and pulling that away from us isn't really in your best interest. In addition to that, ConocoPhillips has spent tens of millions more trying to develop the project from that time.

Finally, I'd like to give you a personal view of what exclusivity does. To me, exclusivity means costs are going to be higher and you're going to have delays. And if that isn't the case, one could look at what's happened with ANGTA [Alaska Natural Gas Transportation Act of 1976], which really isn't exclusive, or the NPA [Northern Pipeline Act] in Canada, which also really isn't exclusive, but [are] classified as franchises. Those projects, those legislations, have not resulted in a pipeline to date. So, in the best interests of time, I'll stop, but I look forward to any questions and any clarifications I may offer.

CHAIR OGAN said if the pipeline is filled to capacity from companies that have gas available to ship at the time of the open season, that limits the ability of other explorers to come on line and might limit the investment by independent gas explorers on the North Slope. The producers already have capacity. He asked about companies that aren't yet exploring in Alaska and that might not come at all because there is no pipeline capacity.

You're not going to prorate it like a true common carrier pipeline, are you? ...I'm worried about that discouraging independent investment, especially in the Foothills.

MR. MARUSHACK stated that the pipeline project has been discussed in earnest for about three years.

Companies had the ability to explore for gas to be ready for an open season whenever it is. ConocoPhillips has explored for gas and we continue to explore for gas on the Slope. So, first of all, companies can explore for gas so they're ready to participate in the initial open season.

The second way is there's the possibility for some multiple open season process that allows a firm shipping commitment so that the pipeline can go forward followed up, then, with some time after that with a second open season that would allow for the final design so that exploration gas could be included.

Third, companies can take capacity on-the-come, what I call on-the-come, which is - I think I'm going to have success - this is what happens in the Gulf of Mexico, this is what happens in the Rockies - so, I'll make a shipping commitment.

Fourth, this pipeline that we've talked about - the 48-inch, the 52-inch, 4.3 BCF a day pipeline - is too big for the base volume that we have. What it does is it allows incremental expansion that is very efficient. So, companies can go out there after the initial volumes have been committed and they can make their exploration successes. We could have an expansion open season; they can get access to it then. I think ConocoPhillips is probably one of those companies that will be in the position [where] we hope we have exploration success. We will ask for an expansion. Hopefully, we will have enough gas to do so. There's a number of ways.

The fifth possible way is the 35 TCF that we know about right now, assuming the underpinning by Pt. Thompson and Prudhoe Bay puts us on a decline around year 12, year 13 - somewhere around that - maybe year 14, but there is a big wedge in the base 20 years that we need new gas. The way companies can get access to that is they can either buy that from companies who have made the firm shipping commitments already or it can be sold and it could be under duress, it could be

at a premium. We don't know, but we do know for sure that in the 20-year period, we do not have enough base gas. So, hopefully there's a number of ways companies could get access to that, sir.

CHAIR OGAN said there is also the issue of whose gas is going to get used first and he was legitimately concerned about the effect on the pressure reservoir and, ultimately, production.

So, if you guys have gas for sale, which you can nominate for the pipeline and the guys up in the Foothills don't have it, the state has an economic interest in making sure that we get the best return on the well, as you do, too. I think we share that interest in a way.

MR. MARUSHACK agreed, "Absolutely."

CHAIR OGAN contended:

But, I think our interests aren't totally aligned, because you have that X amount of gas that you want to sell and you're probably going to sell your gas first, before these other people, these ancillary fields get on line, and that affects production, which affects the state's bottom line. When you lose the pressure reservoir, the performance goes down. AOGCC [Alaska Oil and Gas Conservation Commission] has done a study on that...

MR. MARUSHACK took that point and ran:

Your point is excellent. So, let me give you some examples and then I'm going to go through what has to happen in the future. But, the example I want to give you is if you go back to the decade of 1990 to 1999 and you look at what gas prices were. Gas price, NYMEX basis, was \$2.07 [MCF]. The base tariff we've talked about is \$2.40. Had the pipeline been built and up and running in 1999, the state and producers would have lost a half billion dollars a year. When that happened, had we done that also, your point is even more in effect, because we would not have, at that point, almost three billion barrels of oil that's been traded by Prudhoe Bay through the pressure maintenance that you're talking about. So, that's a valid point;

we're more fortunate the way we have managed together, managed this process.

Now, looking forward on your issue, by the time first gas arrives, we think it's going to be 9 to 10 years for first gas sales from today. That means that not only will we be able to continue the pressure maintenance and the incremental oil production, but we're going to get to the point where you are getting to diminishing returns. Now there is still the possibility for some minor amount of loss on the oil, but I don't think it'll be very significant by the time first gas is out there. I think we'll be at the point where it makes a lot of sense.

MR. MARUSHACK said the project is so complicated that knowing Prudhoe Bay and Pt. Thompson have 30 to 35 TCF of resource is a blessing that other places don't have. It is the base underpinning volume that would make this project happen. "The other thing we know, though, is we don't have enough [gas] to make this a long-term viable project without exploration success."

SENATOR RALPH SEEKINS asked how many of the 40 proposed liquifaction plants that were to go into service in 2008 and 2009 are owned or planned by the producers as part of their plan to meet their 40 percent marketshare.

MR. MARUSHACK replied that he didn't know how many of the proposed plants were legitimate. He explained:

[ConocoPhillips] has an asset in Nigeria that is an LNG possibility and we were working on a re-gas facility in Harpswell, Maine. We're actually a partner on that deal with TransCanada. We were not able to secure the necessary permitting in Harpswell, Maine, on an existing industrial site to make that happen. So, the point I'm trying to make here is - and we had the financing to do it, we had strong partners, we had the gas, we still have the gas - my point is it's not very easy to get the re-gases. Let me point out some others to you. In Alabama, ExxonMobil is having trouble getting their permit for that process. They have the gas; they have the wherewithal to do it. In California, we're seeing a new environmentalist wave is starting to limit to see whose got rights to put the permitting process in place - be it the state or

be it the federal government through FERC - and that's going to take some delays. In Baja, we've seen companies come out of that.

I'm not sure how many there will be, but I'll tell you this. We all need LNG to be successful and the reason we do is - because we need McKenzie gas, Alaska gas, Rockies gas, Gulf of Mexico, LNG gas - if we get gas prices completely out of the range of reasonableness, we're going to see demand destruction. That's a bigger threat to you and I than LNG terminals into the country.

Demand destruction - once you turn and go from gas fired to coal fired to oil fired, it's very difficult to go back in the other direction. So, I'm not worried about LNG; I hope LNG happens, but our focus is still Alaska gas. We need Alaska gas to happen.... The bottom line is I don't believe that anywhere near 40 of those re-gases are going to happen and I don't think too many other people do, either.

MR. KEN KONRAD, Senior Vice President, Business Unit Leader, BP, interrupted to say that BP currently imports gas to two existing terminals on the U.S. East Coast and is looking at one additional BP-owned terminal in New Jersey. BP also has capacity, but not ownership in a proposed project on the Baja.

CHAIR OGAN said all assumptions he has heard at the Energy Council indicate that even with 4 BCF per day of Alaska gas, the U.S. would have to import 11 to 20 percent of LNG from foreign sources by 2020.

SENATOR WAGONER said he is having a hard time determining the difference between a pipeline that would be built by the major producers on the Slope now and one built by MidAmerican, because on the TAPS [TransAlaska Pipeline System] he has seen the producers set up a separate company to build and operate the line. They're both going to be controlled by FERC, because the tariff would be controlled by FERC. He wanted to know what the difference in ownership really meant.

MR. MARUSHACK replied:

The FERC process for access and expansion are exactly the same. The idea that the producers can set something up so that they have preferential rights is

- I don't believe that's right. I could tell you that's not our mindset. So, one of the differences, and I'd like to say that the first thing is if companies can provide incremental value, we need to talk to them. We need to have a seat at the table. This is why I don't think exclusivity is in your best interests at all. So, if that's a pipeline company, if it's a commercial company, whatever it is - a Native corporation or Alaskan individuals - there's a seat at the table to make that discussion happen.

I think what you're going to find is the big difference between the two, possibly, is the focus on having the lowest-cost pipeline and the ability to manage project costs.

MR. MARUSHACK said the producers believe overruns can be minimized by doing the upfront work - getting the engineering the logistics and steel procurement done right and within the first three to five years.

So, it's project management and project execution that I suspect is going to be the big difference. I'll point out something else to you. Alaska isn't like Wyoming.... Permafrost issues, technical issues, working in the wintertime - it's very, very different. BP and ConocoPhillips are operators on the Slope and that's it. So, I think we have something to bring to the table. So, the answer to your question here is from the state's perspective, I think again, the difference you need to think about is who can do the lowest-cost project and how can that be done - and then you just make it happen. In terms of is there an inherent advantage one versus the other, at this point in time, I don't think you can say there is. Hence, everybody should be playing.

CHAIR OGAN said the FERC doesn't entirely control the tariffs. They review it after negotiations and production.

Then if somebody complains about it, they will weigh in and adjudicate it, but they're not really in a position of setting the tariff per se. You guys present your costs and the reasonable costs and they kind of overview it and as long as no one is complaining, there's probably not going to be any action on the part of FERC. Is that correct?

MR. MARUSHACK agreed and said that was a good clarification.

But, I will say this. What's really, really important about this process in my mind is that the State of Alaska and the project sponsor together go to FERC and agree on what those terms are so that there isn't a train wreck in front of FERC and FERC gets put in a position of seeking winners and losers. So, I think that a proposal from whatever the pipeline actually is in terms of the rate and the recovery and those sorts of things will be important to go forward with the state. But, in terms of access and discriminatory practices, FERC is the governing body on those, not the pipeline owner.

SENATOR ELTON stated that Mr. Morgan testified that the majors on the North Slope are now producing about 40 percent of the U.S. domestic gas.

When I hear that, it suggests to me that when it comes to timing issues, when we will be able to move our stranded gas to the market, it suggests to me that the imperative to get the gas quickly to market is maybe less for you than it would be for an independent pipeline owner. You obviously have gas that isn't stranded. You're obviously dominant in the domestic marketplace. So, why should we assume that your imperative is the same as the state's imperative to get Alaska's gas to market?

MR. MARUSHACK replied that the reason the producers have 40 percent marketshare is three years ago many gas traders, like Enron and Dynergy, went out of business.

So, in particular, the reason that number looks big is because of what's happened historically and fortunately your partners are still here marketing that gas.

In regard to your question about who is really motivated to sell the gas, we are motivated to sell that gas. The reason is our share price is driven by the profitability of our company. We make money primarily by finding, development and selling oil and gas. We have many priorities. One of a number of our priorities is commercialize Alaska gas. That means

sell Alaska gas in what we see as the best market in the world, which is the Lower 48. We are highly motivated to sell that. It drives our share price.

SENATOR ELTON followed up saying that earlier Mr. Marushack suggested the price of a producer-built pipeline would be in the neighborhood of \$20 million and he understood the profit motive, but the cost of infrastructure eats into a company's profits. "It seems to me that you could easily make a decision that a \$20 billion cost may eat into your profits a little bit more than LNG from some other non-stranded gas regime."

MR. MARUSHACK supposed he could be right, but said the \$20 billion is assuming a pipeline is built all the way to Chicago.

There seems to be some question about that number and why you say that. The fact is you have to build all the way to Alberta, to start out. From that point in Alberta, you might be able to use existing infrastructure, but the reason we've designed a system all the way to Chicago is because that provides us with a toll that we can compare to using existing infrastructure. So, if existing infrastructure is cheaper, we will do that. If it's not, you build all the way to Chicago. The whole point is to get the lowest cost to market.

Now, your question about our project versus LNG - the reason. We want to bring in as much ConocoPhillips LNG as we can and we want to bring in as much Alaska gas as we can. This is a fiercely competitive business and we want to sell as much oil and gas as we possibly can. Again, we don't make money by holding assets; we make money by commercializing those and selling those and, frankly, we want to out-compete everybody. We want to sell everything we possibly can, sir.

CHAIR OGAN said that the TAPS is an affiliated North Slope project and recently the RCA [Regulatory Commission of Alaska] found that its tariff exceeded just and reasonable rates and legislation was introduced to try to deal with it. He asked why a producer-owned pipeline in Alaska would be different and what assurances would the state have that that wouldn't happen in this case.

MR. MARUSHACK said that was a difficult question, but attempted to explain:

TAPS is a common carrier and this project is an open access contract carriage. The regulatory process is significantly different and I am not an expert on TAPS, but I can tell you that on this pipeline, we will have commitments made, we will have agreements made with FERC that provide the kind of access, the kind of tariff structure, that we think we're talking about here. Furthermore, one of the things that we've long held is that this particular project needs to probably have something that's unique, which is more or less a flat tariff - not an escalating tariff, not a declining tariff - because a flat tariff allows us to capture some value right now and have that remain stable over time. If we were to decline this issue with a normal pipeline, the cost of the tariff up front would be too high.... So, this is a flat type of tariff that we're assuming, which allows us, then, to make this, hopefully, an economic project.

This isn't a trust me one, but the FERC process provides the mechanism that I think we all need to make you comfortable and it's an education process, sir. It's a long process.

SENATOR GEORGIANNA LINCOLN prefaced her concern saying she was bothered that Mr. Marushack now says the pipeline could be in operation between 2013 and 2015 when she remembers talking with her former colleague, Ramona Barnes, about how to motivate the producers to sell their gas over six years ago.

We have been talking for years and years about getting the producers motivated.... What motivation do you have to get that to market at this point that I can feel assured that we are not going to be here 10 years from now with you at the end of the table telling me you are going to be motivated?

MR. MARUSHACK responded:

When you're talking about six years ago, seven years ago, whatever it was, the frustration in Alaska that gas that's been stranded hasn't sold, I would like again to go back to the '90s. The '90s would have been a very bad time to be commercializing gas. You would have had negative royalty, negative severance, we wouldn't be investing in satellites right now.

What's different now? Well, what's different now is though the volatility has got a lot more extreme on gas, the prices are higher right now. They've been higher, on average, for about the last three years. Whether that's sustainable or not, we don't know for sure. What we do know is that our base tariff...is about \$2.40 off this project. Prices are higher than that now and there is a supply demand imbalance, which we hope allows us to move forward. But, the key issue on moving forward is to make sure that we have the lowest cost project, that we've got fiscal certainty with the state - so we know how we're going to be taxed - so those things don't change. We've got a process in the federal government that allows us to get the permitting through and then we can look and see does this make sense. Have we got our toll low enough? Have we got enough certainty on this project?

If you're looking for certainty - anybody to give you certainty on this pipeline project, I would ask you to think about this. The next step in this project is probably \$1 billion in permitting and design engineering and...that's going to take about three years. If this project isn't economic after we've spent another billion dollars, it still won't get done, but we hope it will be.

SENATOR ELTON was incredulous about Mr. Marushack's comparison of pipeline building prospects now to the ones in the last decade.

If six years ago, if you had made a decision to build a pipeline, we would be close to completing a pipeline, we would be selling very expensive gas in the marketplace and the pipeline would have cost less. So, I don't understand why we keep comparing what could have happened in the '90s.

CHAIR OGAN mused that hindsight is always 20-20 and about the current high price of gas contended, "A lot of people who are more educated than me were analyzing [gas pipeline feasibility issues] and didn't see that coming."

MR. MARUSHACK vouched that the supply demand forecast back then didn't support this project.

REPRESENTATIVE ERIC CROFT compared an independent pipeline company with the producers saying that it would have every interest in pushing as much gas, regardless of who owns it, as quickly as possible.

And yet, a producer on-line would be interested in, you said, out-competing everybody with Conoco's gas and Conoco's LNG. At some point, you could have an interest in limiting or delaying production to bring on other assets worldwide. And if that made more money, that would not only be in your interest, it would be your statutory duty to your shareholders to do. Isn't that a major difference between a producer-owned line and an independent line?

MR. MARUSHACK replied:

That would be illegal. What the process under the pipeline is, if people have gas and they ask for that capacity and you can expand, then you have to do that. The other point is the more gas you get down that pipeline, the lower the tariff should be - the more economic it should be. So, the more gas you put down there, the lower that tariff could be for everybody, including ConocoPhillips.

REPRESENTATIVE CROFT asked if producers owned the line, they might have a big interest in negotiating upstream collateral issues to the line (severance or benefits in royalty), but an independent company would have no interest in those issues.

We could end up in a situation where we had a very low tariff, but had given away so much in the upstream that the input to the state was much less.

MR. MARUSHACK responded that this project needs to be looked at as a ringed fence around the entire gas development, which includes the resource and the pipeline.

To the extent that the resource becomes less burdened, if there's enhancement on the resource, then that makes the wellhead higher, that means it's more likely that we can nominate and we can move this project forward. So, there's two components. It's a total economic issue. The one thing we may be able to control is the cost of the pipeline. That needs to be as low as possible. You are right, at the same time,

we need to look at how we can enhance and make the project more competitive and that does include some of the resource issues. That's important for anybody that owns the pipeline, though. They need to have the lowest cost pipeline and the resource has to make sense. You want it that way so people explore.

REPRESENTATIVE CROFT surmised that another difference is that an independent pipeline company would be interested in having multiple shippers whereas the producers' best interests would be served by owning the shipping rights on their pipeline to give them more control.

MR. MARUSHACK parried:

Shipping during the open season, anybody can sign up for shipping commitments - a local distribution company can do it, a producer company can do it.... Well, let's assume that you get enough capacity so people say they want 6 BCF a day. When the pipeline gets built, it's a 6 BCF a day pipeline. The issue you've got, however, though, is somebody is taking a heck of a risk because there isn't enough resource to justify a 6 BCF a day pipeline. But, anybody can take shipping commitments on that pipeline; it does not have to be a producer.

SENATOR SEEKINS said he had not been around the Legislature that long, but he didn't see any way a sitting Legislature can tell a future body what they can or can't do with regards to the tax stability issue. "So, it appears to me that you'll never get that. What are you going to do?"

MR. MARUSHACK professed that was one of the issues to be discussed under the Stranded Gas Act.

I think it's important that we understand the base objective here. Then, we try to figure how we can make that happen. What we're really saying here is, if we invest in this long-term shipping commitment.... [We need to know] that the tax rate doesn't go up directly after that and take back any profit that we thought we were going to make on that - given that you've got market uncertainty anyway.

He felt that the administration understands this issue and everyone is trying to find a way of doing that so the project can move forward.

SENATOR SEEKINS reiterated his concern that he didn't know how that was going to be accomplished.

CHAIR OGAN informed him that the state enters into contracts all the time.

SENATOR SEEKINS said he didn't know how a future legislature could be restricted.

CHAIR OGAN repeated that that is done by contract and a future legislature could undo the contract, but "that would be a lawyer employer act."

5:08 p.m. - 5:10 p.m. - at ease

MR. MARK HANLEY, Public Affairs Manager, Anadarko Petroleum, gave the final presentation. He said that Anadarko shares its enthusiasm for the pipeline project with the previous two speakers.

As an explorer, our interests are also similar to those of the state. We want the lowest cost transportation system. Number one, we want a gasline built; nobody gets its gas to market if a gasline isn't built.... It's one of the better incentives you can do to improve oil exploration, as well, because you find as you explore for oil, you often find gas. If that gas can be commercialized, you can recover some of your investment.

He agreed that getting the lowest rates possible for transporting gas to the Lower 48 is important. [END OF TAPE]

TAPE 04-34, SIDE A

5:13 p.m.

MR. HANLEY said if the Legislature wants to insure access, it needs to understand the FERC process. He explained that the person who builds the pipeline designs the open season process.

FERC doesn't really regulate it. You can appeal afterwards for problems that have occurred, but they

don't regulate it. The terms and conditions of that open season are set by the people holding it. If the state were going out for request for proposals (RFP) for pens and you want 100,000 pens for the state, and I was a pen dealer, would you think there might be a conflict if I got to write the rules for the RFP? That's the concern that we see with a producer-owned pipeline. We see some concerns where there are competitive advantages.

MR. HANLEY explained that the FERC allows for "undue discrimination," which he interpreted to mean that some discrimination is allowed. Also, he revealed that terms and conditions of the tariff give the right of first refusal for expansion to the people who nominate the initial capacity.

It's been done; FERC has allowed it.... I will just tell you there are circumstances where things that would discriminate against an explorer who might not be in the initial [open season], who wants to go explore for gas and be able to expand, wouldn't be able to - because the terms and conditions set by the owners of the pipe make it difficult.

How long the open season is open is another issue that could be appealed to the FERC. Some open seasons have lasted a day, but if a company wants to nominate .5 BCF per day on a pipeline and therefore needs to make a \$300 million commitment over a 20-year period, time is needed to look at all the terms and conditions before signing on the dotted line.

Even the timing of the open season can be, if other people have worked a lot of the details out ahead of time and set the terms and conditions of that and they already know what they are, of course, they've got an advantage. If you don't have adequate time, it makes it difficult.

MR. HANLEY said there are discussions about setting a tariff for this pipeline on a volumetric (MCF) basis versus a thermal basis (MMBTU). Normally, FERC uses MMBTUs.

Some gas, particularly on the North Slope, as it comes out is pretty liquid - has a lot of liquid content, has a high heat content and in many cases, tends to be more valuable. If you [set the tariff] on a volume basis, other gas that's drier - actually there's a

competitive disadvantage there. So, if you set the terms one way or the other, you can create a competitive disadvantage for a company that may be exploring in a different basin. Those are just a couple of examples.

I just want to raise that as a concern for you folks to look at as people say that open access means that everybody can get in. Sometimes you can write the rules and FERC will allow them such that it would be, in our view, discriminatory and we would be at a significant disadvantage to other people.... As a producing company, I can tell you we have that perception, that Mr. Marushack said, of sometimes pipeline companies get a return on their investment, so they don't necessarily have the biggest desire to have the lowest cost. They can't exceed the cost so much that it creates a problem and it makes the project uneconomic. I don't know whether that's reality or not, because in most places we deal with, it is pipeline companies that build these things, but I'll just tell you that's a perception within the industry if you want to talk about a concern the people have on the tariff side. On the other hand, pipeline companies build pipelines all the time. To give you an example, we're an exploration company. We don't drill wells. You might think we drill wells. We manage the wells. We go to Doyon neighbors or something like that.

MR. HANLEY said he didn't know if the producers have their own company that would build the pipeline or if they would contract with someone else to do it. "Our view is that there is an advantage to a pipeline company building the pipeline, because they have that expertise."

He said there might be an issue with the tariff if a pipeline company builds the pipeline, but he didn't believe it would be a very strong one. Anadarko's view is that the pipeline company doesn't care whose gas it carries as long as the money is good. So, they would be interested in having companies that explore for and put more gas down the pipeline.

On the other hand, I guess, we are less comfortable with a producer-owned pipeline, because we see what's in their best interest and their shareholders' best interest.

There's a tremendous value of gas out there to be discovered in Alaska. The discovered resources are in the range of 35 TCF; estimates are there are another 100 TCF of gas yet to be discovered. We would like to go out and explore for some of that. We are in a catch-22; we're not going to go drill wells and have stranded investment - number one - until the gasline looks like it's going to be built. That's a tough one and number two, until we can see what the rates are and number three, until we feel like we can get access to that, because we're not going to go drill a well and have to go to somebody else who's our competitor and ask them if we can get capacity on their line. That won't happen. That's the concern that we have.

MR. HANLEY said he is concerned about a producer owner pipeline, but it really doesn't matter so much who owns the pipeline as long as it has the lowest rate for transportation and as long as the terms and conditions for access are fair.

We might think that an independent pipeline would be more willing to do that, but I would also warn you that, in this case in Alaska, the producers have all the gas. They control it. As we have heard earlier, there will be a commercial negotiation over that. We are also not so naïve as to think that if an independent pipeline company starts negotiating with the producers for the terms and conditions of this tariff that the producers might ask for right of first refusal on expansion capacity, which would not necessarily be a good thing for us. And, with the leverage that people have, they might get it.

So, our view as an explorer is that you should look at fundamentals that you think are important. I'll tell you ours are, as some other people have said, that you've got to get the lowest rate, absolutely. There is no question about that.

Then on the access provisions, you need to make sure that those are included in the Stranded Gas Act negotiations whether it's a producer-owned pipe or an independent owned pipeline. I can tell you that's kind of what went on as we went through the federal energy bill on the federal level. We have language that was negotiated with a whole bunch of parties. Not

everybody is exactly happy with exactly what is in there. Right now FERC does not have a regulatory set to tell you what happens in an open season. To address some of the concerns I raised with you about timing of open seasons, the ability to get the information you need, to have time to do it, to have access, I'll just read you a quick thing. It says:

The commission [FERC] shall promulgate regulations governing conduct of open seasons for the Alaska Natural Gas Transportation project including procedures for allocation of capacity. If the bill passes, that will be in. The regulation shall include the criteria for and timing of any open seasons, promote competition in the exploration, development and production of Alaska natural gas and for any open season for capacity exceeding the initial capacity, provide the opportunity for the transportation of natural gas from other than the Pt. Thompson and Prudhoe Bay units.

MR. HANLEY said that it's important for FERC to adopt regulations to implement those principles.

If we can get, as an explorer, a low rate, which I think is in most people's interest, and fair access provisions, we're willing to pay our fair share. We just don't want to be opted out or have things that are not fair to us. I think you will find companies like ours, and others out there, willing to explore for gas.

CHAIR OGAN summarized that FERC currently doesn't have regulations on the books to regulate the open season for the Alaska gas pipeline and asked if any protocols at all exist now.

MR. HANLEY replied:

There is a general requirement that an open season occur and there are precedents based on issues that have happened. It's an appeals process. If you feel like you were aggrieved in an open season, you can appeal that process to the FERC. There's no question about it. People generally understand what the guidelines are - what FERC would and wouldn't accept,

but I just gave examples of things that FERC has accepted that we would feel would create a competitive advantage for one side against us - that would not necessarily be in our interest and we don't think it would be in the state's best interest to have those, as well.

SENATOR SEEKINS asked:

Because of the leverage the producers may have, you don't see any real clear advantage to either independently-owner or producer-owned in terms of being able to get access at this time?

MR. HANLEY replied:

Not necessarily.... We don't know that the producers are necessarily going to ask for these things that we're concerned about, but they could.... If they do, they've got a lot of leverage.

SENATOR DYSON said he heard earlier that the FERC process is inadequate protection for companies like Anadarko and asked him to comment on that. He also didn't see why the producers couldn't make the same argument - that they should have priority access because they have risked billions of dollars to build the pipeline and Anadarko that hadn't risked anything, but could get in on the same per unit volume rate. "It only makes sense for those who have risk to get a leg up on being able to ship and recover."

MR. HANLEY deftly replied the current FERC process is a lot more flexible than might be thought.

I think it came out that people file rates and if nobody challenges them, FERC doesn't necessarily go through a rate case of determining a just and reasonable rate.... It's usually done on an appeals basis.... It doesn't necessarily guarantee us access or the rates we think [are fair]....

As far as the risk and reward thing, I would say it's interesting as a producer, and we would agree somewhat with the producers, that a large risk is actually in the production. You take the price risk. The pipeline has risk in overrun and other things, but in the end, somebody has signed a contract to guarantee that

capacity. So, the people taking the biggest risk are the people getting that capacity and having to meet those terms whether or not you have gas to put down [the pipe] and whether or not that gas covers the agreed-upon tariff or not. So, I would agree that they are taking a significant risk. If they can justify the initial pipe, they should have the right to that initial pipe.

On the expansion capacity, on the other hand... if we come to the table and we want to nominate capacity, we are going to take that risk. We'll pay for the expansion costs and we will take that same risk. I'm not sure that it's fair necessarily.... That's a policy call that people can make.... Do you want them to have the right to have all the capacity, because they took the initial risk? I will tell you this, it doesn't take a genius to figure out that compared to our risk - we'll have actually in some respects larger risks, because we're going to go out and explore for gas - we don't know for sure if it's going to be there. We take that risk.... We go out and do raw exploration. They're going to want to produce cheaper gas; it's already discovered; there's investments already made. They will have a significant economic advantage over our raw exploration gas. If we go drill new wells down in the foothills, we're going to have more costs than they will overall, probably. So, I think their interests are going to be to produce that gas first and, you heard them, there's a wedge coming. Their interests may be waiting to explore for new gas. I mean, why would they want to find new gas that's more expensive than producing the gas they have? They're going to wait 'til that wedge and decide when it's in their interest to build that.

Our [best interest] is if we can get a reasonable rate and we think we can make it economic, we'll go out and explore right now and we might expand that pipeline sooner than they would or fill in that pipe sooner. I think that's probably in the state's interest. As you said, you have to balance that against the policy call, but they will decide when it's in their interest to either explore for more gas or fill in that wedge. Whereas, if we have fair terms, I think we'll be out there, if we think there's a reasonable chance of success finding gas as soon as we can getting it into

the market - either expanding that pipe sooner [than the producers would]. So, I think there's a value in letting, at least, everyone have fair access to that expansion capacity on an equal basis....

SENATOR WAGONER asked how many other companies he thought would be willing to explore for gas or currently have leases on the Slope that are thinking about exploration.

MR. HANLEY replied:

Remember, it's not just exploring for gas. A lot of guys are exploring for oil, because it is more profitable and they're going to find gas. If they can make some money on it, put it in the pipe, it's going to benefit everybody. There's a lot of companies.

He named Encana, Pioneer, Kerr-McGee, Burlington Resources, PetroCanada, Windstar, ABCG, Total and more.

There are some companies that bought significant positions in the gas areas of the foothills that haven't really done an awful lot, but I think they're doing what we are. We don't drive the process of the gasline, but we're kind of waiting to see what goes forward.

CHAIR OGAN added that a true common carrier pipeline has the access prorated based on whether there's more supply than capacity. "I haven't heard anybody say that's going to happen here."

MR. HANLEY responded that he didn't know of any gaslines that are common carriers.

They're all contract carriers, as far as I know. People talk about the open contract carriage system. It is a little bit different. You go through this open season. Once you get that capacity, it's yours. As you said, on a common carrier, if you're at a million barrels a day and that's the capacity of the line and somebody else finds 100,000 barrels, they get to put it in. Everybody is going to get prorated 10 percent. So, they'll only get 90,000 in and that's how common carriage works.

On the contract carrier side, ownership of the pipeline doesn't guarantee you - if you own pipe on a common carrier, there is a little bit of a difference. You get to nominate on your own capacity. On a contract carrier, you can own 100 percent of the pipeline and it doesn't give you any capacity on that pipe. You get the capacity by bidding at these open seasons where the terms and conditions are set, typically, by the pipeline company, but as you heard here, some of those things are said in negotiations. They'll sit down with the larger shippers that are expected to nominate and negotiate some of those terms and conditions. So, what those terms and conditions are are critical under a contract carrier for people that are explorers.

CHAIR OGAN said he hoped Anadarko could work with the administration to make sure adequate access terms are negotiated in any kind of an agreement and let the Legislature know if they don't. "I think that's probably key to the future of development on the North Slope, jobs, access..."

MR. HANLEY said the governor has made numerous public statements about needing access for explorers and is committed to that idea. Since Anadarko isn't in the negotiations, it doesn't see the specific terms and conditions. He told them that the FERC terms in the energy bill he just read to the committee were put in by U.S. Senator Lisa Murkowski and the administration supported it at the time. The state understands Anadarko's concerns and he hoped it would continue with what it has said is important.

SENATOR ELTON asked if he thought the timing right now was better for a producer-owned company that may be marketing 40 percent of the gas than for an independently owned company.

MR. HANLEY replied:

I don't know. I can tell you in the end the independent company is going to have to go to these companies and get the gas. Either get them to sell it to a shipper or get their own capacity. They have the gas and I've heard them say when it's economic, they're going to do it. Now, are their economic terms different? The pipeline company will do it when they think they can get the contracts. In the end it comes down to a pretty limited number of sellers deciding

when they want to sell their gas and I think it's going to be difficult.... I don't know who has the best timing. In the end it comes down to if somebody comes to them with a better mousetrap, the producers might sell then. It's really their decision, it seems, at this point, when that gas gets developed, because they control the gas.

CHAIR OGAN said that maybe someday soon they would actually build it instead of talking about it. "Let's get the talking part over with. With that, we're adjourned."

5:30 p.m.