

**SENATE AND HOUSE
JOINT JOURNAL SUPPLEMENT**

May 10, 2006

Wednesday

No. 16

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Address

by

The Honorable Frank H. Murkowski

Governor

State of Alaska

Before a Joint Session

of the

Second Special Session of the

Twenty-Fourth Alaska State Legislature

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Wednesday, May 10, 2006

Juneau, Alaska

The following was submitted for publication:

Good morning. George Burns advised that "a good sermon should have a good beginning and a good ending, and they should be as close together as possible." I, too, will try to keep it short.

Let me begin by expressing my gratitude for the work you have accomplished over the past 121 days in the regular session. However, we have some important business left unfinished, as you know.

Legislative bodies rarely have the opportunity to change tax law, because of the political dynamics of the issue.

The transfer of wealth to government is fraught with political landmines. The last time this Legislature changed our oil and gas tax was as a consequence of the Exxon Valdez oil spill in 1989, which resulted in a modest adjustment to the ELF.

A year ago last January, I made an administrative decision to aggregate satellite fields at Prudhoe Bay. This change increased state revenues by nearly \$200 million per year - but it was not popular with everybody.

A quick historical review shows that neither Democrat nor Republican administrations have had the will to take up the task of updating our oil tax laws. This Legislature and my administration now have the opportunity to make major changes in our oil tax. Because of a historic convergence of circumstances.

There is a critical need to put in place a system of taxation that dramatically increases investment in oil and gas exploration, development and production - "TAPS is running dry" under the current fiscal system. We have an existing severance tax system that is broken.

The reason to take action is clear - because with the proposed development of the Alaska gas pipeline a tax change can now take place.

We will revisit the PPT and we will resolve it.

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But it is appropriate to consider today the loss of revenue this state will endure for every day we continue under the ELF.

While the proposed 21.5 percent tax rate, which passed the House and failed in the Senate was more than we recommended. The Department of Revenue estimates that at \$60 a barrel, the 21.5% tax rate will generate an added \$1.417 billion annually. This is approximately \$3.8 million per day in lost revenue. The progressivity factor included in the House bill would have brought in another \$826 million, or more than \$2 million per day. The combination of the two total a potential revenue loss of \$5.8 million per day at \$60 oil. That revenue increase would have had a profound effect on state services, as well as the Permanent Fund.

In the proclamation we issued yesterday calling you into this special session, we delineated six subjects for your consideration. All of these are inter-related, and lead toward one goal - your complete understanding - along with all Alaskans - and approval of the gas pipeline contract we have negotiated with the North Slope producers.

I am pleased to announce that at 10:30 this morning I released the draft contract, the preliminary fiscal interest finding, and related documents. I would again remind some members that the Stranded Gas Act that they voted into law requires confidentiality. The documents are all on the internet. All 900 plus pages of them.

When we set out to negotiate the contract, we laid down six guiding principles that must be included:

- Alaskans deserve a fair share of the revenues.
- Alaskans need access to the gas.
- Future explorers must have access to the gas pipeline.
- The gas pipeline must be expandable.
- The state should own a share of the pipeline.
- Alaskans deserve pipeline jobs.

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I believe we have negotiated a contract that achieves all those objectives.

This gas pipeline project is the largest in the world after the Kashagan project in terms of barrels of oil equivalent. It will require the largest capital investment in the world. It provides the largest bookable reserve in the world on a single project. It also provides the largest total net cash flow in the world, by a wide margin.

The gas pipeline project provides significant additional strategic benefits to the investors through project synergies, such as further exploration and development, and gas marketing.

The project also holds huge economic risks of low prices and cost over-run - due to increasing steel prices. Another risk is to determine where between Alberta and Chicago the optimum economics work. There are price risks, such as possibly strong LNG imports, the large reserves of stranded gas around the world, and the volatility of the North American markets. Qatar has the largest supply of gas in the world - the cost of this gas is not an issue, like Alaska's gas - it is simply what they are willing to sell it at. Low internal rate of return relative to other projects puts the Alaska gas pipeline at risk. The draft contract before you improves the internal rate of return relative to the 2005 fiscal terms, compared to other projects.

We have two options to make a project more attractive: lower the government take or participate in the project to lower the cost to other investors.

In comparing these two options, the proposed contract - with the state participating - improves the internal rate of return to the same degree as if there were no royalties, no production taxes, no property taxes, and no state corporate income taxes. In other words, the improvement in the internal rate of return is made possible through the state's risk sharing and participation portion of the contract. The state takes its royalty and production tax "in kind" and assumes its own shipping commitments and marketing risk. The shipping commitments are the financial underpinning for the financing of the gas pipeline. The state's risk sharing and participation proposal does not affect government revenues.

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Over the 35-year operating life of this contract, total income to the State of Alaska ranges from a low of \$12.5 billion (at \$2.50 per thousand cubic feet). To a high of \$78.2 billion (at \$8.50 per thousand cubic feet). For the project ending in Alberta. In other words, as the contract is structured, the state's risk sharing and participation results in essential improvements in the economics of the project, and results in significant new revenues.

It is important that we focus on the very large picture of the entire gas pipeline project. That process began in Washington, D.C.

I spent years in the U.S. Senate working to achieve the federal legislation that was secured to assure and support building the gas pipeline. That set the stage for a series of important next steps. One of the most important was to help the producers see that the project was attainable, and to reduce economic risks. It was equally important to understand and explain what the Stranded Gas Act was all about. And recognizing that the producers needed fiscal certainty on oil.

Washington's View:

Alaskans are not alone in monitoring our negotiations on the gas line:

- Both Congress and the Bush administration have expressed the strong Federal interest in commercializing North Slope natural gas as an essential component of US energy policy.
- Senator Grassley and other members of the Senate have written the North Slope producers expressing their strong desire that contractual negotiations with the State be concluded as soon as possible.
- Similarly, Speaker of the House, Dennis Hastert, has emphasized the importance of North Slope gas. So has the Chairman of the House Committee on Energy and Commerce, which has jurisdiction over gas pipelines.
- Reflecting the long standing position of the Bush administration, the Secretary of Energy and the Chairman of the Federal Energy Regulatory Commission have congratulated the State on progress to date and have expressed the hope that our contractual negotiations will soon be concluded.

- Acting on a virtual consensus in the House and Senate, Congress passed legislation in 2004 that is designed to facilitate permitting and construction of a gas pipeline. This legislation was complemented by other provisions providing a Federal loan guarantee and certain tax credits.

Are you aware that --

- Further underscoring Congress' interest in commercializing North Slope gas, a provision was enacted requiring the Secretary of Energy to conduct a study of "Alternative approaches to the construction and operation of such an Alaska natural gas transportation project" if an application for pipeline construction has not been filed with FERC within 18 months of the provision's enactment.
- Further, the provision requires the Secretary to "take into consideration the feasibility of establishing a Federal government corporation to construct an Alaska natural gas transportation project" and to study "Alternative means of providing Federal financing and ownership."
- And, on April 13th, the Department of Energy began the study required by this provision. This study is now in the "Pre-scoping" phase to establish the framework and to determine staffing and funding.
- I don't think any of us, including the Bush administration, wants to see Federal ownership of the pipeline. However, this is a possibility that we may all need to contend with if a contract is not consummated soon.
- In addition, the Federal Energy Regulatory Commission is paying close attention to our contractual negotiations. The Commission has submitted an initial status report to Congress on the negotiations and will do so on a regular basis from now on.

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- All of this activity in Congress and the Federal agencies leads to the inescapable conclusion that if the State and producers do not soon agree on the terms for commercializing North Slope gas and constructing the pipeline, these issues may be taken away from us. At that point, we will lose control of our own destiny.

This is the status of the federal oversight of our gas line as late as yesterday communicated to me by John Katz, Special Counsel and Director of state/federal relations in my Washington, D.C. Office.

This contract does much more than take our gas to market.

- It is the key to establishing a long-term gas industry in Alaska.
- It will generate significant state and municipal revenues over the project's life.
- It will create employment opportunities for Alaskans through stipulations regarding employment and training.
- It will provide in-state access to natural gas for use in homes, businesses, and industrial plants. Stipulating that the tariff in-state users will pay will be prorated from the North Slope to where the gas is consumed.
- It will generate income for Alaska businesses by providing increased economic opportunities.

In short, the Alaska gas pipeline provides a bridge to our future.

Today, I am asking you to start on the process of deliberations, and later approve amendments to the Stranded Gas Act that will be needed to conform the draft contract to state law. As you examine the contract and its associated documents, you will understand and - I am confident - agree with the necessity of the Stranded Gas Act amendments. I am also asking you to begin the public review process of the draft contract.

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I appreciate that you are working with our administration on the public outreach on this issue. And have already scheduled public hearings on the contract, starting this afternoon at Juneau's Centennial Hall.

The Department of Revenue has the responsibility for presenting the public hearings and informational briefings all across the state over the next month. This schedule includes three regional or statewide teleconferences to receive the opinions of those who cannot attend a public hearing in person.

Our gas pipeline negotiating team will meet with the sponsor group's team to address any issues within the contract that need to be revised. After the final contract and fiscal interest findings are achieved, they will be presented to you for your approval.

Clearly, after 2 years of negotiating, I can say this has been a long road to get to the milepost where we are today. Yet, we have miles to go - and we must do what's right for Alaska.

But, working together, I am confident we can and will get there. Alaskans expect this administration and this Legislature to get it done, and get it done now - in this session.

We have been waiting 30 years. We don't have to keep putting 8.6 billion cubic feet every day back into the ground at Prudhoe Bay. We will have a gas pipeline contract, because the economics support this project NOW! And the state must have the revenues to meet the needs of Alaskans. Construction of the gas pipeline and its attendant facilities is not only in the best interests of Alaska and her people. It is key to Alaska's future.

I cannot over-emphasize the historical opportunity we have before us - the decisions we make over the coming weeks will have a profound and lasting impact. I strongly urge your favorable consideration of the contract and the issues related to it - you should have all the time you need.

Thank you.

Please report corrections to the Senate Secretary's office.