

**SENATE AND HOUSE
JOINT JOURNAL SUPPLEMENT**

July 13, 2006

Thursday

No. 17

Address

by

The Honorable Frank H. Murkowski

Governor

State of Alaska

Before a Joint Session

of the

Third Special Session of the

Twenty-Fourth Alaska State Legislature

Thursday, July 13, 2006

Juneau, Alaska

The following was submitted for publication:

Good morning.

Thank you for coming to Juneau during what I know is a busy time of the year for each of you.

This is my third opportunity this year to address this joint body on a subject that will have lasting consequences not only for us, but for our children, and our grandchildren, and perhaps even our great grandchildren.

I would like to address you not as Democrat or Republican, but as Alaskans. For the issue facing us today is greater than party politics, greater than petty bickering, and greater than your job here as legislators, and greater than my job here as governor. The issue is a rare and historic opportunity to authorize the largest construction project ever undertaken in our state. A project that for the next 50 years will solidify the economic foundation of our state for generations to come.

The one thing history must not judge us on is inaction. Winston Churchill once said, "No action is in fact, an action." I intend to work with all members of this legislature to get our job done, no matter how long it takes. Clearly the time for this gasline is now.

To share with you, at current prices, we would generate more than \$100 billion over the next 35 years, extend the life of TAPS for 20 more years, which would bring us another \$50 billion in revenue, and cement in a solid foundation for economic growth for at least the next 50 years.

Without a gas pipeline, the oil flow through TAPS will end around 2030 with a catastrophic drop in state revenue. The people of Alaska want and expect us to stop arguing and get a gas pipeline contract approved. Now! This session.

We have negotiated almost two years, spent millions of dollars on consultants. Senator Ted Stevens was right in what he said last Friday, "We need to finish the job in this Legislature, or you may find

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

yourselves delayed for two years with no further progress. He was also right in saying that we need to take the politics out of this and do what's right for Alaska. With a gas pipeline, our future is secured. Without it, we face uncertainty.

This special session comes at a crucial time in our negotiations, because clearly the competitive world of energy is not standing around waiting for us to make a decision. First, we have had a clear message to move the gas pipeline project forward now from the Vice President of the United States, Dick Cheney; Secretary of Energy, Samuel Bodman; Senator Ted Stevens; Senator Lisa Murkowski; and Representative Young; and most recently, from the Federal Energy Regulatory Commission or FERC.

The FERC report on your desks describes the signable, fiscal contract we have with the producers as "significant progress towards development of an Alaska natural gas pipeline." FERC warns, "Whether the project sponsor begins developing an application, and conducting field surveys in the spring of 2007, depends largely on the Alaska state legislature acting this summer." "If not," FERC adds, "the Alaska gas pipeline will be further delayed." FERC notes that two years are required to complete the work to get to the filing of an application.

FERC emphasizes that the project is threatened by the growth of imported LNG, and I quote: "In the next two to three years, the worldwide capacity to supply LNG to the market will greatly increase....Alaskan gas is not the only option available to the Lower 48...twenty years ago, Alaskan gas would have been in competition only with other North American gas production. Now, Alaskan natural gas production will also face competition from low-cost production in LNG exporting countries across the globe. Qatar's cost of lifting gas is 5 cents." Ours is far higher.

The FERC warning continues, "Gas buyers in the Lower 48 are more likely to enter into long-term LNG contracts if there is no substantial progress on building an Alaska pipeline and, the longer an Alaskan pipeline is delayed, the more strength is gained by the proponents of LNG. The estimated cost of an Alaska gas pipeline has increased since October 2004 (ANGPA) from \$18 to \$20 billion to as high as \$25

billion. Any further delays may serve to make the Alaska gas pipeline uneconomic in comparison to LNG imports. As demonstrated by the magnitude of monies being invested in LNG facilities, and the falling costs per unit of LNG infrastructure, Alaska is at risk of being marginalized in the search for new natural gas supplies for U.S. consumption. Prompt action by the project sponsors, Governor Murkowski and the Alaska legislature is necessary to enable Alaska to provide a reliable continental source of natural gas for the Lower 48, that will not only assist in the growth of the U.S. economy, but also contribute to the economic well being of the state of Alaska," and, FERC adds, "timely action on an Alaska natural gas project will allow North Slope gas to reach the Lower 48 states."

The message from FERC is clear: act now or risk losing the project to the increasing supplies of imported LNG. Explaining to our children how we missed on the gasoline could become a reality.

One reason for holding a special session now is the threat of the reserves tax. By exacting what I view as a punitive tax of \$1 billion per year from now until first gas, the reserves tax adds at least 8 to 10 billion dollars in project costs. The producers can only recover 40 to 45 percent of the tax after first gas, and perhaps much less – depending on gas prices and when the project actually starts. The net present value of this on the gas pipeline is devastating and will kill the project regardless of who is in the legislature or in the Governor's chair.

The idea of penalizing the project by increasing the cost nearly 50 percent before any revenue is generated from sales is simply absurd. You don't tax projects into existence – you incentivise them. It will also halt exploration for gas and oil on the leases where the action is taking place – Prudhoe Bay, Kuparak, Alpine, Point Thompson. It will halt exploration for gas on those leases because if you find it, it will be taxed. It will halt exploration for oil because if producers are exploring for oil and find gas they will be taxed. It will thus halt investment in both oil and gas.

With such investment disincentives, the flow of oil through TAPS, which is already experiencing a substantial annual decline, will cease long before 2030. That is why I instructed my gas team to protect the

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

project from the reserves tax. They have done so in the gas pipeline contract, but to protect the project the contract must be in place before the November ballot.

We are having the special session now so I can get the necessary approvals and negotiate changes to the contract with the producers in time to obtain ratification before November. Those who advise you to gavel out and go home without acting or to wait until November are either ignorant of the LNG and the reserves tax threats to this project, or don't care.

As you know, we negotiated a contract with the producers that they are ready to sign. We have held public meetings around the state and we are prepared to make changes to the contract based on those comments—all as the SGDA directed us to do. Alaskans now expect you, the legislature, to do your job.

Another reason for this special session: the petroleum production tax! I have not changed my mind. I am introducing the PPT at the same tax rate I have in the last two sessions. You may ask, "Why would I do that?" After all, both the House and Senate made substantial changes to our proposal:

- Increasing the tax rate
- Tweaking the credits
- Adding progressivity

No doubt, you believe these amendments improve the tax regime. I don't agree, and here's why.

First, my proposal of 20-20 was acceptable to the producers. That doubled their tax by over 1 billion dollars.

Second, we don't need the short term, slightly higher revenues a PPT rate in excess of 20 percent might bring. With higher oil prices we already have a substantial inflow of revenues. Rather, we need substantial long-term investment by the producers and the rest of the

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

July 13, 2006

No. 17

industry in a gas pipeline, heavy oil, and small traditional fields, to monetize our gas and arrest the substantial annual decline in oil flowing through TAPS.

We get both with the 20/20 proposal I negotiated last February with the producers' CEOs and which I urge you to accept. 20/20 gets us a gas pipeline agreement and more investment in the North Slope. This means two more Prudhoe Bays: 13 billion barrels of heavy oil and 12 billion barrels of oil-equivalent of gas.

In this case, more short term revenue means less total revenue to the state. Since our job under Alaska's constitution is to maximize our resources for the benefit of the people, I urge you to accept the 20/20 approach.

For the producers, the 20 percent is far beyond what they wanted to pay – they initially proposed 12 percent. 20-20 will give Alaska the highest government take in North America.

The real prizes here are the gas pipeline and substantially more investment in the North Slope. We need to focus on what Alaska gets, not what the producers get.

People have argued that since the producers agreed to this, they would be willing to pay more. But this is a negotiation. Both sides reached an agreement and had to give some. If there is an attitude that anything the producers agree to is unacceptable, the project is doomed to failure. By focusing on what the producers get, we could get nothing, as has happened with the Hebron project in Newfoundland. Yes, it can happen.

We have listened to Alaskans and we have listened to you regarding items that we must make sure are right in order to obtain ratification. We will be holding additional meetings around Alaska between now and July 24th to provide feedback on what we are considering changing. This suggests:

--- No fiscal certainty on oil until project sanction – 4 to 5 years from now.

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

--- Fiscal certainty for 14 to 16 years for construction of the project and a capital recovery period.

This change in fiscal certainty is meant to help you accept my 20 percent PPT tax rate proposal – or whatever PPT rate you set.

For example: on fiscal certainty on oil, I am proposing the approach adopted by the Senate and by House Judiciary and that rate would be the effective contract rate.

Some are advising you to simply repeal "ELF," leaving a gross severance tax in place for oil. A gross tax simply collects revenue based on the number of barrels of oil produced and collects no more when oil prices are high. I am surprised that the proponents of this approach seem willing to accept the proposition that the legislature is not up to making tough decisions. Like the reserves tax a gross tax is self defeating for Alaska because substantial industry investment in the North Slope is absolutely critical to our future. A gross tax does not deduct operating and capital costs and thus provides no incentive for the producers to invest in Alaska. The producers will invest instead in countries like Norway or the U.K. where they get a deduction for operating and capital costs.

One has to question the motives of some Alaskans who support a gross tax now, yet made their wealth after expensing their cost and paying taxes on their net. Moreover, the timing effects of the deductions/credits proposed in our PPT bill is also intended to make North Slope investment attractive. As soon as investments are incurred they can be monetized—years before taxable production ensues. This will increase the net present value and rates of returns which will make investing in Alaska even more attractive.

Finally, consider the impact of our PPT proposal on exploration. Under the present system, if a pure wildcatter comes to Alaska to explore and drills a dry hole, he goes away empty. The state shares none of his dry hole risk. Under the PPT, through credits and deductions, the state would share 40 percent of his dry hole costs and this is a very significant means to reduce dry hole risk and promote exploration. Finding new oil is the key to keeping the pipeline filled up. With a tax based on gross, none of this happens.

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

July 13, 2006

No. 17

Why am I so concerned about North Slope investment? Oil-flows through TAPS were at 822,000 barrels/day during the last fiscal year. That is 10 percent less than last year and 17 percent less than five years ago. Our projections show TAPS shutting down in around 2030. We need substantial new investment to arrest this decline.

Getting investment in a gas pipeline also changes this result, by adding at least two more decades to the life of TAPS to 2050. This will give us time to do the research necessary to develop the estimated 13 billion barrels of heavy oil on the North Slope.

Most of you have previously voted for a net profits tax. Stick with it because it will get us the substantial investment which Alaska needs.

The argument has been made that we need a gross severance tax because:

--- It is simpler.

--- The producers will game us.

I put in a 19-page bill in February that dealt with 98 percent of the oil affected by the PPT. There has been concern about the ability to audit upstream costs with the PPT. This is ill-founded. Currently, the Department of Revenue audits transportation costs under the ELF based-system without a problem. Going to upstream costs is only a small step. We get the producers audits of each other on costs deducted by the operator on each field. We get each producers' federal income tax return.

In short, we have had great success in protecting Alaska's oil income. "Gaming" is not a good reason to give up the benefits of a net profits system.

An important issue is how will we spend the funds from an enhanced PPT?

I need you to fund now a portion of the first year's revenues for the PCE endowment. Gasoline charges in rural Alaska are in the \$8-9 range. Rural Alaska businesses-even fishing-are being stifled by the

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

high cost of energy. The Rural Energy Action Council (REAC) is addressing these concerns. Full funding of the PCE endowment will provide substantial assistance in rural Alaska.

Further, our ability to take gas in kind as the gas contract provides allows us to use the Yukon river takeoff point to strip propane and butane from the gas and barge them to villages along the Ayk river system—thereby lowering rural energy costs.

I will be introducing next session a proposal to fund a feasibility study to develop a lateral all-Alaska line possibly along the railroad right-of-way from Fairbanks to Mat-Su – Anchorage and the Kenai peninsula.

We must make every effort to insure that the Agrium and the LNG plant continue to operate as they appear to be key elements in the economics of the project.

Alaska property taxpayers also deserve relief. In the next regular session of the legislature I will propose the use of PPT revenues to refund \$1000 to each residential property tax payer in the state. My friend Mayor Begich mentioned this to me and said he would get democratic votes for it. Are you with us Ethan?

Another measure I will be introducing – to offer Alaskans an opportunity to purchase shares of stock in the pipeline – A.H.F.C. is working up the details which would allow Alaskans the option of a check-off on their permanent fund to access stock purchases. This will offer Alaskans an ownership share in the economic engine of our state.

I would propose that we put aside the remaining PPT money as savings—for gas pipeline capital cost among other things.

Last night Nancy asked me:

What does this pipeline debate really mean to the average Alaskan? She expressed concern that Mr. and Mrs. Average Alaskan may not relate to the multi-billion dollar numbers and decades-long timeline of the pipeline debate.

\$1 billion more per year in oil tax revenues.

Nearly 10,000 construction jobs.

More than \$100 billion in new state revenues in the first 35 years of operation of the gas pipeline.

An additional 20 years of operating life of the TAPS oil pipeline, to 2050.

An estimated \$25 billion more deposited into an already \$35 billion permanent fund, resulting in larger PFDs.

Sitting here in 2006, it may be difficult to visualize something that can happen in 2050. Looking back, we have gotten along very nicely for a quarter century with no personal income tax. Before it was repealed in 1980, working Alaskans paid the state an additional 16 percent of what they paid the IRS. Do a back-of-the-envelope calculation on your own to see how much you have kept in your wallet. We believe that with the gas pipeline, there should be no reason for a personal income tax in Alaska. Likewise, there should be no need for any statewide sales tax.

The gas pipeline will mean bigger dividends, because 25 percent of gas royalties will be deposited into the permanent fund. It will extend the life of TAPS by 20 years – this means 20 more years of 25% of oil royalty deposits into the Permanent Fund – or \$12.5 billion dollars.

You may not be able to visualize the benefits to yourselves of something happening 30 and 40 years into the future but there are young Alaskans – our children, grandchildren and great grandchildren – who will be here at that time and will benefit from our good decisions today.

Alaska is blessed with an abundance of natural resources that are important to the nation and the world. The gas pipeline is the key to moving Alaska into that more secure and stable future.

Alaskans want their sons and daughters to have better opportunities than they have had here. We want them to have a better quality of life – better educational opportunities – health care – security, job opportunities, caring for our seniors and others who are most vulnerable.

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

Another important factor in this prospect is job training and the role of our labor community. We must provide training and opportunities for Alaskans first. We also must recognize this project cannot be built without a project labor agreement which I support and urge labor and the producers to start meaningful discussions.

It is our duty under the constitution – under the oaths of office we all signed – to maximize the value of Alaska's resources for the benefit of the people.

I firmly believe we will fulfill that obligation under the PPT and gas pipeline contract we have set before you. Ours is a long-range view of maximizing the resources not one of short-term gain that cuts off the future and leaves resources undeveloped in the ground.

As the legislature, you have the power to approve our vision of the future or not, as you choose, but if you do not choose wisely I believe with too high a tax rate, and less incentive, the producers will gradually withdraw from Alaska.

At 20-20 our total government take is higher than the Gulf at 42, Canada at 49. Our proposal that has been accepted is 60 percent government take.

If Alaska does not remain competitive, industry will extract as much oil from their North Slope reserves as they economically can before they roll up the pipeline and go away by about 2030 but long before that, the state of Alaska will be forced to find other sources of revenue to pay for state services.

What would those sources be? A personal income tax, a statewide sales tax, and tapping the permanent fund, reducing everybody's dividend. Alaskans do not want that to happen.

We all can recall a couple of years ago, before the run-up in world oil prices brought budget surpluses. We recall the gut-wrenching decisions that had to be made and the palpable fear among Alaskans that we were headed back to the mid-1980s. Nobody wants to give up their dreams, lose their jobs and walk away from their homes. Some expressed the sentiment in the 1980s that the last person to leave the state should turn out the lights.

To avoid these Draconian alternatives, the people of Alaska have asked over and over again for a fiscal plan. Well, here's our fiscal plan. \$1 billion more every year through a 20/20 PPT. Build a gas pipeline to bring in \$100 billion over 35 years. Extend the life of TAPS by 20 years – adding \$50 billion in revenue from oil we would not get without a pipeline. It is my job to persuade you of the logic and soundness of this fiscal plan and to get your support for it.

We are building the bridge to Alaska's future. Are any among you intent on tearing the bridge down? Or will you walk across it with us? The choice is really up to you.

To recap the reasons I have asked you to return to Juneau:

- 1) The PPT is left undone and that indecision is costing Alaska \$3.2 million every day, or over 400 million since February 20 when the producers accepted our proposal.
- 2) The federal government is urging us to move this project forward in the public interest.
- 3) The punitive reserves tax is on the November ballot and will kill the gas pipeline if it passes and the contract is not in place to protect the project.
- 4) And, we must attract the substantial investment necessary to stop the decline in TAPS throughput.

You and I will be held accountable by every Alaskan for the decisions we make here whether those decisions are good or bad.

In conclusion – let's get to work and get this gas pipeline moving now.

As a summing up, I would consider emphasizing that we have a choice:

SENATE AND HOUSE JOINT JOURNAL SUPPLEMENT

No. 17

July 13, 2006

A - With the 20/20 PPT and the proposed contract we have a very good chance of doubling oil taxes at current prices and getting a gas pipeline with tremendous riches;

or

B - By trying to get a little more, we have a very good chance of ending up with nothing.

A bright future is before us. We must reach out for it now. That is my vision I wanted to share with you and all Alaskans today.

Thank you.

Please report corrections to the Senate Secretary's office.