ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE
May 21, 2006
6:15 p.m.

ACTION NARRATIVE

SENATOR GENE THERRIAULT announced the start of the legislative consultant availability at 6:15:40 PM. He stated that the consultants would each give a brief introduction, which would be followed by a question and answer period.

6:16:13 PM

CONSULTANT AVAILABILITY

6:16:52 PM

RICK HARPER

6:17:59 PM

RICK HARPER, Arbitrator, Legislative Consultant, began by giving a history of his 34 year involvement in the [oil and gas] industry, both corporate and private. He worked with the Atlantic Richfield Company (ARCO) for 15 years. During this time, his responsibilities included all North America natural gas activities, regulatory affairs and strategic planning, among others. He stated that after his 15 years with ARCO, he remained involved with the company for the following 9 years. He noted that his involvement with ARCO ended with the acquisition of ARCO by BP. He also served as President and Chief Executive Officer (CEO) of Canor Energy Ltd., as well as assistant to the president of the United Gas Pipeline, and Senior Vice President of Northwest Natural Gas Company.

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MR. HARPER went on to say that for the past 14 years he has been involved in consulting. His work in this area has been both domestic and international, and his clients have included Canada, Equatorial Guinea, Bulgaria, New Mexico, Louisiana, Shell Corporation, and Anadarko Petroleum Corporation, among others. He said “hopefully that’s instructive in terms of ... understanding my biases and perspectives relative to the gas line and related agreements ... and documents.”

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MR. HARPER explained that he would be identifying issues and concerns, as well as areas [of the contract] that offer benefits. Generally, he said, this contract seeks to redefine the states legal, regulatory, administrative and taxation rights. He opined that the agreement is effective in achieving this objective. He stated that the agreement does not appear to move the state from litigation to non-litigation strategies, but rather redefines historic relationships to creates commercial and business relationships. The contract, he said, has been negotiated based on perceptions of the states strengths, weaknesses. Mr. Harper said that he has a "pretty good feel" for the administrations view of the strength of the states position. He noted that there are concerns regarding the states ability to enforce its existing obligations on a timely basis. He surmised that this was considered when the agreement was drafted, and said "a great deal of effort has gone into the construction of this agreement. And I think the producing companies involved have thrown a great deal of time and talent – probably their top talent – at this agreement." He noted that he is not "in full accord" with the assumptions underpinning the agreement.

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MR. HARPER referred to the cover page of the Alaska Stranded Gas Fiscal Contract (the contract), which contains the following statement

> All terms included in the attached are DRAFT in nature. The agreement to any one term is contingent upon the agreement to all other terms. All terms are subject to ultimate review and approval by all Parties.

MR. HARPER indicated that he has not seen any provision in the contract that would allow the contract to expire, if one or more party were to remain indecisive or delay its decision. In addition, he pointed out that the contract is between the State of Alaska and three subsidiaries of BP, ExxonMobil Corporation, and ConocoPhillips Alaska, Inc. He said, "it is important to understand who you are doing business with," in regard to both the assets, restrictions on those assets, and any liabilities. He added that in his experience, in agreements that are a "fraction of the size of this [contract]" it is important to know the credits, assets, liabilities, credit worthiness, and

the ability to transfer assets. He said that the limited liability company (LLC) that has been created to "own" the pipeline will most likely be owned by different subsidiaries.

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MR. HARPER pointed out that he does not see a work commitment provision in the contract, adding that he "does not equate diligence with a work commitment." Generally, he said, diligence is a standard by which to measure whether commitments are being made. He said "if it's being suggested that diligence is a proxy for work commitment, I would say that it is not." Typically, he would expect to see a due diligence or prudent operator standard. In addition, there is no standard for reasonable or "best" efforts; however, he said, this is a business transaction, and commenting on one portion does not suggest that the whole [agreement] should be disregarded.

MR. HARPER said that normally, a due diligence standard is "the effort made by an ordinarily prudent or reasonable party to avoid harm to another party or himself. Failure to make this effort is considered negligence." However, in the contract, the diligence standard refers to what is prudent under the circumstance, and contains several exclusions, including an exception for "errors in judgment." Therefore, he opined, the diligence standard appears to excuse both negligence and gross negligence.

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MR. HARPER, in regard to the arbitration provisions of the contract, said that "baseball arbitration" is uncommon in oil and gas activities; however, he is familiar with this type of arbitration. He noted that the contract relies on arbitration for the resolution of all disputes. He quoted from the definition section of the contract, which reads in part:

> ***"Dispute"*** means a dispute, matter, controversy or claim between the *State* and a *Participant* arising out of or relating to any of this *Contract's* Articles or Exhibits, including its interpretation, construction, performance, enforcement, privileges, rights or obligations.

MR. HARPER said that this definition "encompasses everything, and I would argue also encompasses payments." He stated that

the agreement also provides for an "amicable resolution process," which he has heard referred to as "mediation;" however, he opined that this is simply a process established for the two parties to meet at a higher level within the organization, in order to seek resolution. He expressed concern with the scheduling and timeframes provided in the contract, noting that the selection of arbitrators is a "very lengthy" process.

MR. HARPER stated while he understands that the economic incentives of the agreement may motivate the party's behavior, there is no specific requirement for production of oil or processing gas, once the pipeline is completed. This, he said, has been an issue in the industry. He explained that for many years, all producer sales into interstate commerce were required to be certificated through the Federal Energy Regulatory Commission (FERC). During the 1970s natural gas shortage, he said, the FERC imposed "reasonably prudent operator" standards by ensuring that the producers deliver gas into interstate commerce using the best of their ability.

MR. HARPER pointed out that the state will not have ownership of the pipeline, rather it will own a share interest in an LLC. Ownership rights on a share basis differ from those on an asset basis. He opined that concerns regarding the aforementioned rights, along with voting rights, rights of transfer, operations, and rights of sale are important to understand. In regard to capacity management, he said that a conscious decision was made to take delivery of production at a "very upstream point in the production chain, at or near the field." In doing so, this creates "a host of very complex issues." He said "the team that I have been dealing with, I believe, in that instance, has – given the assumption that that is where the point of delivery needs to be or has to be, from a trade standpoint - ... done a very ... thorough job of trying to manage that issue and quantify risk."

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MR. HARPER went on to say that [the consultants] considered doing a risk assessment on what this type of pipeline management study would entail; however, the [Lukens Energy Group] recently released a study which suggests that it is difficult to quantify the risk of managing capacity with deliveries. This study also shows a broad range of uncertainty, with the shrinkage in net present value to the state ranging from 1-11 percent, depending upon how the permeations of managing net capacity unfold.

JAMES BARNES

6:36:00 PM

JAMES BARNES, Legislative Consultant, began by giving a brief history of his experience in international oil and gas matters. His educational background includes a bachelor's degree in mathematics, master's degree in resource economics and a juris doctor degree in law, along with diplomas in international law from several European universities. His work experience includes employment as a negotiator and lawyer in the international division of "Florida Gas Company," Tenneco Oil Company, and British Gas Company. He has spent the last 12-13 years working as an independent consultant.

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MR. BARNES, referring to a PowerPoint presentation titled "[Stranded Gas Development Act] SGDA Presentation, Jim Barnes, Final, 06-05-21," explained that Alaska uses a lease structure with a tax royalty payment, managing through regulation. In regard to the international comparisons, there are two types of agreements. These are: lease agreements with no stabilization, and product sharing agreements which provide stabilization. He stated that comparisons are "powerful tools" and it is important to consider them in context.

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MR. BARNES, with regard to the parties involved in the contract, said that under a typical production sharing contract (PSC), the host government would be the granting party and regulator, with a national oil company acting as the entrepreneur. The investor, he said, would appear as a local subsidiary that would be backed by a parent company or bank guarantee. In the fiscal contract, he said, the state would "appear to act" as the entrepreneur and guarantor of the Alaska subsidiaries that will form. While the [consultants] are not clear on this, he said, the agreement is written as though the state is the primary acting party. The various subsidiaries would also be members of the midstream LLCs. The producers, along with the midstream LLCs will be participants in the granting instrument; however, there is no parent company on behalf of the participants, which may ultimately be needed.

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MR. BARNES went on to say that the area found in a PSC usually applies to a single block. He explained that "ring fencing" is a fiscal term used in regard to limiting the application of the [PSC] to the area of the block. In addition, he said, there would be a relinquishment clause which would state that if the investor does not commit to develop in a finite period of time, the PSC terminates and the block must be relinquished. In the fiscal contract, he said, all of the producers' Alaska North Slope (ANS) units. If needed, he stated, more will be added, while others will fall away if not produced. It is not ring fenced, nor does it include a relinquishment clause.

MR. BARNES explained that the terms of the PSC are typically 4-8 years, during which time the parties need to perform a minimum work commitment (MWC) and commit to develop. If the investor declares "commerciality," which is a financial feasibility determination made by the investor, he said, the investor must prepare a plan of development (POD) to be approved by the host government. Once approved, the investor has 20-30 years to develop and produce oil and 30-45 years for gas production. Under the fiscal contract, there is no primary term to perform qualified project program (QPP) or commitment to develop. The initial period ends when the mainline entity declares project sanction. "AK Pipeco" will be a participant in this decision as a member. This alignment is likely to be different than the state would have as a regulator. He said that there does not seem to be a provision for approval of the QPP by the state.

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MR. BARNES said that in a PSC, the MWC must be performed during the primary term. If the investor fails to do so, the PSC terminates. He reiterated that if the investor declares "commerciality" it must then prepare a POD, which is then subject to government approval. If approved, the plan will move forward and must develop per annual work program and budget (WP&B), which is also approved by the host government. If the investor fails to commit to develop during the primary term, the host government may terminate the PSC. Under the fiscal contract, he said, the participants must perform with "diligence." He pointed out that the mainline LLC has the ability to modify the QPP, and does not appear to require any approval other than by the parties to the mainline LLC. The state can only terminate the fiscal contract if it can prove the parties are not acting with "diligence." In regard to management and control tools under a PSC, the national oil

company (NOC) would participate in both upstream and midstream decisions, while the host government would continue to fully regulate operations per local law. Both the host company and the NOC would participate in approval of the annual WP&B and the POD. In the fiscal contract, he said, neither the state nor its subsidiaries participate in upstream decisions. The subsidiaries would participate in midstream decisions, although the extent of involvement is currently unknown. He stated that the FERC has been given regulation authority, adding that in Canada, this authority has been given to the National Energy Board (NEB). This is, he said, an exclusive grant of jurisdiction. He explained that the fiscal contract removes the jurisdiction from the Regulatory Commission of Alaska (RCA) and restricts the authority of the Department of Natural Resources (DNR).

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MR. BARNES said that under a PSC, the government take is usually a combination of royalty, profit share, local obligation to supply gas, and taxes. In regard to the royalty share, the government may either take in-value or in-kind. If the NOC takes in-kind, it would take the gas or oil in marketable condition and pay transportation and marketing costs. This would also apply to the profit share. The producers would also have a commitment to supply the local economy with its petroleum needs. Finally, he said, there is an accompanying tax structure. In the fiscal contract, the royalty is in-kind. The "AK Gasco" would take the gas in unmarketable condition, and would have to pay gathering, treatment, transportation, marketing, and disposal costs. In regard to the taxes, these will be taken in-kind, and the aforementioned payments will apply. There is no local supply obligation [in the fiscal contract]. However, the state will receive an "impressive" amount of payments in lieu of taxes (PILT's) and other "fiscal obligations."

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MR. BARNES concluded by comparing the ownership of assets. Under the PSC, the NOC or host government would own all assets. These assets would be paid for by the investors, who would have a right to use the assets. Under the fiscal contract, the producers pay for and own production assets. The LLCs will pay for the upstream transmission, GTP, and mainline and NGL processing assets. The state, he said, would own an interest in

various entities which will in turn own interest in the midstream companies.

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DON SHEPLER

6:51:44 PM

DON SHEPLER, Lawyer, Legislative Consultant, began by giving a history of his experience with the FERC. Some highlights include staff attorney for the [FERC] staff, trial lawyer in pipeline rate section of the commission, and chief in-house regulatory council for: Northwest Pipeline Corporation, KN Energy (now part of Kinder Morgan, Inc), and Colorado Interstate Gas Company. During his employment as chief regulatory council for the Colorado Interstate Gas Company, he was an active participant in management decisions in all aspects of the company, including the certification process.

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MR. SHEPLER said that his comments would focus on the FERC aspects of the contract. He agreed that trust and alignment are important when attempting a joint venture between the state and private companies; however, the state has a "unique" interest in the pipeline. He opined that the state "can probably never be totally aligned with the producers – the partners in this contract." While both parties share the same goal of building a pipeline, he said, the state has a second agenda which includes expanding the pipeline in order to create a "robust industry of gas production on the North Slope." This interest, he stated, is not shared by the producers.

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MR. SHEPLER pointed out that in the fiscal contract, the state does not appear to have authority to approve changes to the project plan. He went on to say that the project plan was update on May 10, 2006, of which changes the timeline is most significant. He explained that the fiscal contract specifies that the project plan will be updated on an annual basis, and pointed out that there is no provision for the state to acquiesce to the changes. Unless the state has, by agreement, authority to consent to changes in the project plan or authority in addition to its 20 percent project share, he said, there is nothing firm and binding in the contract. The producers can

then change, delay, or redirect the project plan without the consent of the state. He opined that the state would be inclined to change the project plan in the event of a increase in steel prices or a decrease in gas prices. However, if the proposed change was to delay the start date to 2009, he said, the state would need to have additional authority.

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MR. SHEPLER stated that his focus has been on the questions of access and expansion. In regard to access [to the pipeline], he said, the contract is not "inappropriately silent," and follows the guidelines set forth by the FERC. The legislature filed comments with the FERC, which stressed the importance of access and early expansion of the line. As a result, the FERC issued an order that was "highly favorable" to the legislatures requests. The FERC agreed to focus on the sizing of the pipeline, and committed to requiring any design changes needed to ensure the pipeline would be readily expandable. This, he said, is a "major benefit" to the state. However, he said, the producers have appealed this portion of the FERC finding, which is currently scheduled to begin briefing in the summer and decided by the end of 2006. He opined that during the negotiations process, the state had an opportunity to request that the producers withdraw the aforementioned appeal in order to solidify this portion of the FERC ruling.

MR. SHEPLER went on to say that the FERC ruling also contained a declaration to establish a presumption in favor of "rolled in pricing for pipeline expansions." Referring to a graph titled "Indicative Expansion Tariffs," he said:

> Basically, it's contemplated that the pipeline can be expanded – at least a couple of times, to take the capacity that you see from four and a half or four billion cubic feet (Bcf) a day, up to about six [(Bcf)] a day, by relatively low cost compression. This means you put new compressors or pumps on the pipeline. They're relatively inexpensive, [costing $10 million-$20 million]. They provide lot's of bang for the buck, more capacity for not a lot of investment. In those cases, whether you do rolled in pricing or the alternative, which is called "incremental pricing," the rate goes down. You have more volume with relatively fewer costs being stacked on, [needing to be] recovered. But at some point down the road, when the pipeline can go from [six billion

> Bcf per day to seven billion Bcf per day], the low cost expansions are no longer available. There [is an] engineering limit to how much capacity – how high you can run the pressure, how many miles apart you can put the compressor stations. At that point, you've got to go to the expensive looping, which ... is putting more pipe in the ground. And you go back and you put miles and miles at various locations, of the [various sizes of pipe], and that gets very expensive, it's like rebuilding the pipeline ... for those miles. If you roll that expansion in, which means you take the new pot of dollars, all of the [old and new] investment, and you divide through by the new capacity, you get ... a lower rate ... for the new shippers, than if the new shippers have to [exclusively pay for] the cost of the expansion. That's shown graphically on the right side of the graph. If you started with a $0.97 rate, the rolled-in treatment might push the existing shippers rates up a few cents to $1.02 [as shown by the graph], but that's a rate that if you rolled it in, everybody would pay. So, you would have a level playing field. The alternative, if you have incremental pricing, is that the existing shippers would [pay the $0.91 rate], and the new shippers would pay $1.61.

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MR. SHEPLER continued:

> Well, the bottom line is ... that expansion is just not going to happen. So, by determining how you are going to price that expansion capacity, you effectively determine whether or not that expansion is ever going to take place. If that has to be priced on an incremental basis, it'll never happen. The pipeline is capped at 6 billion [Bcf] a day – it will never go to [7 billion Bcf per day].

MR. SHEPLER went on to say that the FERC assisted the state by setting a presumption in favor of rolled-in pricing. While this is "rebuttable," it is the current FERC policy. The fiscal contract, he said, is silent regarding voluntary expansion. There is no commitment in the fiscal contract for a voluntary expansion, nor is there commitment to the terms under which an expansion might be priced. He said "that, to me, is a bit of a gap." He expressed surprise at this, and added that he would

expect a commitment to expand in engineering increments. There are, he said, "logical amounts of capacity you can create, for logical amounts of expansion dollars, at the request of credit-worthy customers on a rolled-in basis, and that's just simply not there." He remarked that this is "curious."

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MR. SHEPLER, referring to the slide titled "Mandatory Expansion Under 2004 Federal Law," said that there are eight conditions that must be satisfied prior to mandating an expansion. These conditions specify that existing shippers must not subsidize expansion. However, this statute has not been judicially tested, and if the FERC were to act on it, there is a possibility for appeal and delay. While the contract is silent regarding mandatory expansions, he said, it creates a state-initiated expansion alternative. This alternative maintains the aforementioned mandatory criteria and adds an additional 10 requirements. The state-initiated expansion must not require the existing shipper to pay a higher rate than without an expansion, or to be assessed at a higher fuel retention percentage than without expansion. In conclusion, he said, the federally mandated rule is not viable, and the state-initiated expansion does not facilitate expansion of the pipeline. He opined that voluntary expansion based on economics is the best vehicle for pipeline expansion; however, the fiscal contract does not include terms under which this type of expansion would take place. He added that while he did see a draft of the contract in October 2005, neither the access terms nor the work commitment provisions have improved.

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JAMES EASON

7:12:32 PM

JAMES EASON, Legislative Consultant, began by giving a brief history of his education and experience. His educational history includes a bachelor and masters degree in geology. He has 32 years of experience in Alaska, which includes work with the oil and gas industry, government, and private consulting. He stated that he has worked with Atlantic Richfield Company (ARCO), along with the Conservation Division (currently the Minerals Management Service) of the United States Geological Survey (USGS), aiding in the understanding of resource potential, designing lease terms, and conducting lease sales.

In addition, he served as both Deputy Director and Director for the State of Alaska, Division of Oil and Gas. In 1995, he said, he began working in the private sector, doing consulting on technical issues related to oil and gas, in addition to helping clients understand and comply with the applicable regulatory systems. He continues to work with the [oil companies], in addition to providing strategic advice and offering litigation support for the law firms representing these companies.

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MR. EASON explained that his goals include assisting with the explanation and interpretation of the agreements to the best of his ability, in regard to the areas of his expertise. He said "I think one of those goals is to help identify collateral affects where we see them." There are, he stated, many collateral and related affects which flow from the combination of the contract and its exhibits, in addition to the Production Profits Tax (PPT), among others.

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MR. EASON stated that the fiscal contract and related work is "very preliminary," therefore his comments will be "preliminary." He said:

> In the absence of having seen all these agreements, it's ... impossible at this point to tell you, with any finality, where there are connections and linkages that may be important to you in your decision [to move] forward.

MR. EASON said that [his goals also include] identifying the packages of "concessions and trade-offs" made by both parties; however, this is not entirely possible, as the "people who know with finality what those were, were the people that sat in the rooms over the last two years." He opined that this is an important part of the analysis process. In identifying these [packages], he said, there will be some fiscal and non-fiscal consequences which need to be identified. He stated that while the [consultants] are available to offer understanding of the various connections and implications of the agreement from individual perspectives, any "red flag" issues will be pointed out, and alternative solutions will be given. Finally, he said, he will be available to answer questions that the legislature may have.

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MR. EASON quoted from previous testimony on the fiscal contract as follows:

> And when you look at it, in one sense, every part of the contract has some fiscal consequences.

MR. EASON opined that this is important to keep in mind. He stated that his focus would be on the in-kind taking provisions of the contract, which he feels is a principle discussion point. The in-kind provision was one of the earliest decisions made in the fiscal contract negotiations. From this, he said, flow a number of other issues. To put this decision in historical context, he explained that under the current law, the state has the option of taking its gas in-kind or in-value. These provisions are included in all leases and unit agreements.

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MR. EASON explained that the current notice provisions are "very problematic," as longer notice is needed for a project of this kind. In this case, he said, [the state] is making an irrevocable commitment to take gas in-kind, both as royalty gas and as tax gas, for the term of the contract. In doing so, he stated, a number of related negotiations were made. Under the status quo, the point of delivery is defined by the lease and the unit agreement. Typically, he said, this is taken at the unit boundary. In addition, under the existing leases, the obligation is on the producers to provide the oil and gas in marketable condition. Under the value provisions of the lease, the state has "very, very favorable" lease terms. These terms were designed to fit the balance of a competitive lease under which the state retained 1/8 royalty and the producers maintained 7/8 royalty. These agreements provide that the state retain the higher amount or a minimum value, to be established by the commissioner. In regard to the revenue, he said, there is a separate set of principles which guide the evaluation. Generally, he said, the ground rules have evolved over time, and are "pretty good ... given all of the [previous] unknowns."

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MR. EASON reiterated that under the terms of the contract, the state commits to taking full-volume, full-time. The point of delivery, he said, moves upstream. This creates added costs,

and the state assumes responsibility for its lease expenses on the total volume. When this occurs, the state loses a number of things, including loss of the valuation provision. In addition, there is a change in the definition of "gas." Under the leases, he explained, gas and oil are defined consistently as "hydrocarbons." Under the fiscal contract, the definition is changed to include hydrocarbons as well as impurities such as CO2 and H2S. Taking a volume of impurities as gas results in loss of marketable gas volume. The state is also assuming the cost of disposal of the aforementioned impurities.

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MR. EASON noted that disposal of these impurities is "not a regular activity," and will be dealt with by commercial arrangement, the rates of which are not defined. In regard to litigation, he pointed out that there is a long standing history of this on a number of oil and gas royalty issues, in addition to tax issues. Currently, he said, the Commissioner of the Department of Natural Resources does not have the authority to issue an oil and gas lease containing provisions allowing field costs for the lessee. The fiscal contract will reverse the provisions of the unit agreements in regard to field costs. The fiscal contract also specifies that the state will pay a 22.4 percent per Mcf cost allowance on all state gas. This will escalate with the consumer price index and will last for the term of the project; however, this does not apply to gas subject to an upstream facility gas payment and gas tax. He noted that this is not a comprehensive list of the fiscal consequences.

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MR. EASON stated that the non-fiscal policy considerations include the importance of retaining the right to take gas in-value or in-kind. He opined that regardless of whether this right is retained, it is "proper" to make long-term commitments in this type of gas contract. However, he said, it is important to decide whether these terms are appropriate and should extend for the life of the project.

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MR. EASON pointed out that the in-kind taking provisions move from administration by the Department of Revenue (DOR) and DNR, to an arbitration panel. He surmised that the arbitration procedures are limited and "may not [fully capture] what we may hope." In regard to the costs the state would assume according

to its lease obligation, he said that exhibit D of the contract lists the participant's current North Slope leases. He noted that any future leases acquired by the participants would also fall under the fiscal contract agreement, in addition to the potential of the Uniform Upstream Fiscal Contract bringing in additional leases. Therefore, he said, it is impossible to give a sense of the range of [the costs].

MR. EASON stated that the gas volume is capped at 70-75 trillion cubic feet. This does not limit the gas volume subject to the aforementioned payments and fiscal consequences. He reiterated that the intent of the agreement is to apply the 22.4 percent per Mcf cost allowance to each Mcf of the states royalty and tax gas. In closing, he opined that the agreement is "extraordinarily seamless," and added that a lot of consideration and detail has been included in the drafting of the agreement.

7:38:41 PM

SENATOR THERRIAULT announced that there would be a short break prior to the start of the question and answer period.

The committee took an at-ease from 7:38 PM to 7:52 PM.

QUESTION AND ANSWER PERIOD

7:52:28 PM

SENATOR THERRIAULT announced the beginning of the question and answer period.

7:53:03 PM

REPRESENTATIVE RALPH SAMUELS, Alaska State Legislature, asked Mr. Harper to specify the type of scenario that would result in the producer's unwillingness to produce.

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MR. HARPER replied that it is presumable to say oil companies would produce if the pipeline was built and the companies were paying for capacity on an on-going basis. However, one could also question whether TransCanada or Kinder Morgan, for example, would produce, were it to build a pipeline at its own risk. He offered his understanding that the parties would be in the same

situation under the fiscal contract, as it does not contain an affirmative obligation to produce.

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REPRESENTATIVE SAMUELS, in regard to the work commitment, asked how the state can balance the preferred start date with the potential lawsuits and regulatory problems that are outside the states authority.

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MR. BARNES replied that typically, in the international arena, minimum work programs require regulatory approval. He explained that each time a boundary is crossed, there are extensive problems. Usually, he said, rather than attempting to plan out the timeline at the beginning of the project, the government will propose a "reasonable, best efforts" deadline. As the end of the deadline approaches, extensions are given on an exception basis, rather than attempting to stop the process.

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REPRESENTATIVE SAMUELS pointed out that in the fiscal contract, the [pipeline company] has veto power over any changes made by the FERC. He inquired as to the point of this.

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MR. SHEPLER replied that Article 8.7 of the contract contains a provision, which reads "if FERC issues a certificate on a basis different than the expansion proposal filed by the Project Entity, then the Project Entity shall reject the certificate." Therefore, he said, it is correct that the state initiated expansion may result in a limited term expansion, which must be approved by the FERC.

7:59:10 PM

SENATOR THERRIAULT, in regard to moving disputes from the court to the arbitration process, commented that the courts may offer deference to the governmental entity, as long as its system is "fairly reasonable, applied fairly and not arbitrating [capriciously]." He questioned whether this deference would be lost when arbitration is used.

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MR. BARNES replied that this is his understanding. He pointed out that "arbitration is dispute resolution by contract." The terms of the dispute resolution would be governed by the rules of the arbitral body. Unless the contract provides for deference to the states regulatory decisions, or the arbitral rules provide for deference, this would be lost.

8:00:32 PM

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, asked arbitration under contract would "renounce [the states] use of the courts, if the arbitration does not come out to where [the state] wants it to go."

8:01:06 PM

MR. BARNES replied yes. He explained that in general, arbitration is considered binding. He said:

> At that point, the adjudication of the facts is over. Now, arbitral panels do not have an independent ability to enforce an award. So, the provision in the agreement says the parties can take that arbitral award, and they can [certify] it in a court. But, they can not raise new issues. So, when you ... certify, it is simply that the arbitral panel has now issued its award, and the court is going to lend its authority to the enforcement. Typically ... the losing party will ... pay the terms of the award. If for whatever reason, that [didn't] happen, that's when you would ... certify the arbitral award with a court. But, it's not ... a 'hearing de novo,' where you start with the facts and go over, it's a very, very restricted process. It's simply to say 'court, here is the award, now please enforce it.'

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REPRESENTATIVE SEATON expressed concern with the upstream cost allowance provisions and how these interact with oil. He inquired as to what impacts the upstream costs would have on oil, and what the ramifications are.

8:03:22 PM

MR. EASON offered his understanding that there is no affect "directly flowing" from the contract, or any allowance for oil field costs. There is no inventory of whether the cost allowance is for oil or gas. Rather, this is an agreed upon amount that parties have negotiated for each Mcf that flows. He stated that there are agreed upon amounts for the royalty share from Prudhoe Bay. This agreement provides that the amounts will continue, and the areas that have existing cost-allowances, these will also continue. He added that there are cost-allowances for oil and for gas, which apply to the remaining leases and any new leases brought in by the three participants, under the terms of the contract. In addition to the aforementioned leases, he said, the leases related to the uniform upstream fiscal contract are candidates, as well. He stated that he does not see any attempt to change existing provisions for oil cost allowances.

8:05:53 PM

REPRESENTATIVE SEATON asked whether there would be any cost deductions an oil company producing oil and gas would be able to take on its expenditures and how this would interact with the 22.4 percent cost allowance.

8:06:15 PM

MR. EASON offered his understanding that the deductions available under the PPT are separate and cumulative, and will be in addition to the allowance for the field cost.

8:06:52 PM

SENATOR THOMAS WAGONER, Alaska State Legislature, asked what the cost would be to remove impurities from the gas, and inquired as to whether the state would receive credit for the aforementioned liquids.

8:08:52 PM

MR. EASON replied that under the terms of the contract, the cost of disposal will be borne by the state, for its share of the royalty and tax gas. He stated that it is unclear where the disposal will take place, as the contract specifies this will be decided in the future and the cost will be decided in "commercial negotiations."

8:10:53 PM

MR. HARPER added that he has not seen any provision in the contract explaining how the impurities will be handled; however, he would separate treating the gas, which is the removal of impurities, from processing the gas, which is for-profit removal of valuable liquid hydro carbons. The location and ownership of a natural gas processing facility have not been determined, he said. It is also unclear whether the location and ownership would be within the confines of the LLC, or whether the LLC would contract with a third party processing facility.

8:12:20 PM

REPRESENTATIVE MIKE KELLY, Alaska State Legislature, asked for information on the time frame for identifying the "red-flag" issues and corresponding recommendations. In addition, he inquired as to whether an additional consulting group would be retained to look into progressivity.

8:13:41 PM

SENATOR THERRIAULT replied that EconOne is still under contract to answer questions regarding the PPT. In regard to "red-flag" issues, he explained that [EconOne] has been asked to specify the various levels of concern. He indicated that there would be additional "round table" discussions in order to address issues of concern.

8:16:31 PM

REPRESENTATIVE JOHN COGHILL, Alaska State Legislature, in regard to the work commitment, asked for clarification of "deliverables."

8:17:21 PM

MR. BARNES replied:

> What normally happens in a production sharing environment is that ... it arose out of a situation where the state wanted to [retain] more control over the investors in their country. So, the regime was created to effect that greater degree of control. [As a result, approval is required at each step.] In particular, there's a finite period of time in which certain work needs to be done to get to the point where the decision is made either to commit to develop

> ... or not. The deliverables, at that point in time, are largely a plan of development. The plan of development includes not only field development, but how that oil and gas is going to be taken to market. So, it's a midstream question as well. The plan of development is then presented to the State. The national oil company is participating in this process ... [however,] the state is then maintaining its regulatory authority. The control ... is affected in two ways. [First] through the participation, but it's also the standard regulatory control done through approvals.

8:19:09 PM

REPRESENTATIVE COGHILL said:

> Maybe that's one of the things that I'm struggling with. It may be a nature of the beast and taking our gas in-kind and becoming a part owner together with [the oil companies]. Does it seem like we are sacrificing the ability to get to a more definitive work commitment?

8:19:30 PM

MR. BARNES replied that the ability to approve a pipeline project exists. Most foreign jurisdictions do not have the extensive regulations; therefore the project is presented in a comprehensive plan which specifies how it will be moving forward. In regard to diligence, he said, throughout the production sharing contract, the investor is obliged to act with diligence. This is simply a "standard of conduct" that is expected. In the fiscal contract, he said, the burden of proof has been reversed. In a production sharing contract, the investor is driven by a deadline. Exceptions are possible; however, the burden of proof is on the investor to show that the work has been done diligently. In the fiscal plan, the presumption is that the participants are moving ahead with diligence, with the burden of proof placed on the state. He opined that proving the participants are not diligent will be difficult.

8:22:39 PM

MR. EASON added:

> The actual language of what is diligence for the purposes of this contract, and thereby for the purposes of the work commitment ... [is unique]. There are diligence standards that are ... widely used in the oil and gas industry, [and] there may be some dispute about them; [however], in certain jurisdictions, those disputes have ... narrowed over time [due to decisions and] court precedent. When you sign a contract that [includes this], you know the limits of what you're going to be arguing about with greater detail than you would if you were just starting with a clean slate. The [Fiscal Contract] is ... a uniquely clean slate. If I just stood back and said "how would I enforce this," if I ... were in a regulatory setting where [arbitration was not used], if I decided on behalf of the state that [the oil companies] weren't being diligent, how would I ... make that argument.
>
> [The fiscal contract modifies the aforementioned diligence standards] by saying that the diligence is "prudent under the circumstances." It makes a difference when arbitrators are given this standard ... versus one that is more aligned with industry practice. But also, the standard is qualified further, by providing a list of ... potentially ameliorating circumstances ... that almost seems ... asymmetrical. It [appeared to be] designed ... to provide [many] caveats that seemed to go in one direction, and ... the burden of proof is fairly high. Couple that with the arbitration procedures, where ... the arbitrators are limited to a very narrow consideration, it's a different provision than I've seen.

8:26:45 PM

MR. HARPER stated that the consultant's intent is not to make a policy call, rather to raise the issue for the legislature to focus on this during its deliberations. Presently, he said, the prudent operator standard is in effect for the states leases, in the covenant to develop, market, and account accurately. He opined that the responsibility of the consultants is not to condemn the fiscal contract operator standards, but rather to show the difference, which is significant over industry custom. He read a written description of the prudent operator standard as follows:

> The prudent operator standard, analogous to the "reasonable man standard" and negligence, governs the performance of covenants and oil and gas leases. The standard obligates the lessee (the producer) in developing and protecting the lease premises, to do whatever in the circumstances would reasonably be expected of operators in similar circumstances of ordinary prudence, having regard for both the interest of the lessor and the lessee, with a reasonable expectation of [recovery of cost and profit].

8:28:53 PM

MR. SHEPLER added that prior to project sanction, the contract provides that the states exclusive remedy for a claim established through the tribunal is termination of the contract. This provision can be found in Section 5.5 of the contract. He reiterated that if the goal of the state is to build a pipeline, a remedy "more akin" to specific performance to enforce the project plan may be more appropriate.

8:30:25 PM

MR. HARPER brought attention to Article 37.2 of the contract which reads in part:

> **37.2 Limitation on Damages and Remedies. The *State* and *Participants* have negotiated this *Contract* in consideration of their consent to limit recovery of certain *Loss*. Accordingly, in no event is any *Party* liable to any other *Party* for the following *Loss*, however caused, that arise out of or relate to this *Contract* or any breach of it:**
>
> **(a) any consequential or incidental damages, including lost profits; or**
> **(b) any special punitive damages.**

MR. HARPER expressed respect for the companies involved in the contract; however, he opined that there are times when an operator may feel it is worth the risk of not completing a task, if the only penalty for this is to be told to "go and do it." He said "the hammer has always been the fear of consequential punitive damages, and on the case of other operators, lost profits." He stated that the manner in which this may or may

not govern the behaviors of the participants, when weighed against the other provisions of the contract, is a part of the total, and should be considered.

8:32:14 PM

REPRESENTATIVE LES GARA, Alaska State Legislature, asked for a an example of the percentage lost with the loss of the right to the higher value [of gas].

8:34:21 PM

MR. EASON replied that the states experience with gas is virtually limited, as its business thus far has primarily been oil, with the exception of Cook Inlet. He stated that it is impossible to forecast what the range in prices may be; however, the Department of Revenue (DNR) may have more information available to answer this question.

8:36:44 PM

REPRESENTATIVE GARA, in regard to an earlier question, asked if receiving 7.25 percent, which includes the impurities, rather than the value for taxes, does in fact result in the state losing 10 percent of revenue.

MR. EASON replied that this is an engineering question, which requires quantification.

MR. HARPER added that this information is ascertainable; however the consultants have not yet arrived at this information.

REPRESENTATIVE GARA inquired as to the point at which the gas price would be less than the cost to remove impurities, thereby causing the state to lose money.

8:38:10 PM

MR. EASON replied that this is an EconOne question. There are several costs associated with taking the gas in-kind; however, data from the Lukens study takes into consideration the possible risks, in an attempt to quantify these in association to the in-kind taking, transportation, and marketing. This study provides a range of potential fiscal impacts, which was as high as 10 percent of net present value.

MR. HARPER added that owning a pipeline and subscribing to capacity are different issues. In regard to long-term transportation, he stated that there is a demand charge and a capacity charge. The demand charge typically has the fixed cost included in it. He said that participants in the industry who purchase long-term firm transportation make the demand payment regardless of whether gas is moved; therefore, it is a sunk cost. He said:

> So, when you're viewing your decision 'go [versus] no-go,' it's just like you ... drilled a well. You might want to amortize those costs for tax purposes and SCC net income purposes, but the fact of the matter is, when you make a decision to sell or not sell, it's a cash flow decision. And that's a sunk cost.

8:40:49 PM

REPRESENTATIVE GARA expressed interest in seeing a comparison of what the state may lose or gain by taking the gas in-kind versus in-value.

8:41:11 PM

REPRESENTATIVE JAY RAMRAS, Alaska State Legislature, expressed concern with "a considerable anti-trust challenge ... on the well-head side of the [pipeline]," and inquired as to the way by which the state may incentivize exploration by small companies.

8:43:17 PM

MR. SHEPLER replied:

> [In regard to] the anti-trust piece, ... our law firm [has] done some work [on this issue]. There are two ends of the pipeline, and there are questions about ... impacts on competition, depending on who owns the straw between the supply and the consumer. Having said that, ... the question we focused on was a follow-up to the question that had been posed to the FERC about ... [reverting back to the] 1970s ... prohibition on producer ownership [of a pipeline]. The suggestion that ... comes out of that is: You would eliminate that issue to the extent that you had an independent pipeline, rather than a pipeline that was affiliated 2/3 or 80 percent with the producers. [However], we are not dealing with an independent

> pipeline, we're dealing with a contract with the ... producers, so whether or not there's more or less competitive regulation ... associated with a producer pipeline than an independent pipeline, [has] ... become irrelevant now that we have the proposed contract with the producer group.

MR. SHEPLER went on to say that in the Lower 48, it is uncommon for the producers to own a pipeline. The majority of the pipelines are owned by independent pipeline companies, and the producers take out transportation contracts. In the last ten years, he said, the pipeline companies have established marketing affiliates. He stated that the FERC is mindful of the various circumstances that may occur as a result of these.

8:46:46 PM

MR. HARPER said " [this] issue has ... dominated a lot of our discussions." He opined that understanding the pricing on expansions is vital, as the answers are "important determinants" on how independent companies are going to evaluate Alaska. He offered his belief that the 35 trillion cubic feet in question is "one of the biggest proved resources ... available." He added that this is "the tip of the iceberg" in Alaska.

8:48:14 PM

MR. SHEPLER added that the producers have a long lead time between the beginning of an exploration program and commercialization. The companies, he said, must know on day one that if production is successful, they will have a chance to "get into the pipeline."

MR. EASON stated that incentivising the companies to explore is secondary to providing fair and adequate access to the pipeline and expanding the pipeline. He agreed that there is little incentive to explore Cook Inlet until there is a "way to get [the gas] out." He said "the goal of oil and gas companies is to explore, find, produce, and keep this cycle over and over again. I think that's going to take care of itself."

REPRESENTATIVE RAMRAS said:

> It just strikes me that the whole nature of the credit side of this PPT debate is about unlocking the resource value of the basin. [However] a great deal of this fiscal contract that we're contemplating seems

to be about locking up and controlling the value in the basin. Am I mistaken to keep drawing that conclusion from where a lot of the dialogue has gone over the last week and a half?

8:51:15 PM

MR. HARPER replied that [the legislature] would most likely hear from the independent companies through the comment process. He opined that it is a “key policy” question as to how this “sorts out.” He said that the question is whether it is going to occur and the probability.

MR. SHEPLER commented that the state and the producers are aligned with the need to build a pipeline. He reiterated that the state has an additional focus on the pipeline expansion so as to maximize the competition on the North Slope.

REPRESENTATIVE RAMRAS inquired as to whether the fiscal certainty offered is a minimum or maximum of what is offered in other countries.

8:52:26 PM

SENATOR THERRIAULT noted that “fiscal certainty” was previously referred to as “fiscal stabilization.”

MR. BARNES agreed, and added that "fiscal certainty" is often referred to as "fiscal stabilization." He explained that [fiscal stabilization] can occur as a “stand-still,” which prevents future legislatures from making future changes. While it is possible to “contract away” the state's prerogative to change, the longer the term the more uncertain this becomes. Fiscal stabilization, he said, can also occur as a renegotiation mechanism. This is also known as an economic equilibrium provision. In this situation, if the states fiscal laws change and [the company] is adversely impacted, renegotiations will be made to economic equilibrium. He stated that the fiscal stabilization provision in the contract is “the most sophisticated” he has seen. He explained that the aforementioned provision contemplates that the legislature may make further fiscal changes; however, it affectively limits the economic effect. Article 22 of the contract addresses how the different taxes will be dealt with so as to not increase the burden.

REPRESENTATIVE RAMRAS asked who benefits from the complexity.

MR. BARNES replied that it accrues to both parties. The intent of the SGDA is to provide fiscal certainty. The contract, he said, has been evaluated under the context that Alaska is willing to undertake fiscal certainty in order to develop the gas reserves. This has resulted in the producers and administration negotiating the fiscal certainty. He stated that this is advantageous to the state as long as the pipeline is built under the appropriate terms, and to the producers in that it appears to be a fiscal stabilization mechanism that is likely to function. He noted that there has been debate regarding the constitutionality of the agreement.

8:57:35 PM

SENATOR GARY WILKEN, Alaska State Legislature, asked how the [Alaskan residents] will be incorporated [in the decision making process] through the administration and the legislature, to "march ahead" as the contract is validated and implemented.

SENATOR THERRIAULT replied that the consultants in attendance would be available for any questions that may come up. He noted that he is attempting to quantify the pluses and minuses of the contract. He opined that there will be questions regarding alternatives that may provide additional protection to the state that would also monetize the production.

9:01:34 PM

SENATOR WILKEN asked if the legislature would hold scheduled meetings in order to initiate open and free dialogue with the administration.

SENATOR THERRIAULT replied that consultants were able to meet with the administrations' negotiating team earlier in the week. He added that [his office] would try to facilitate more face-to-face meetings between the consultants and the administration. He stated that the SGDA amendments would be considered through the regular committee process. The consultants, he said, would be available to all committee chairmen hearing the aforementioned legislation.

9:03:36 PM

SENATOR THERRIAULT went on to say that, based on comments made during the public comment period, modifications may be made to the contract. He stated that, during the legislature's

deliberations on the contract, he would be willing to facilitate a continuation of the discussions with the consultants and include the administrations perspective.

9:04:17 PM

SENATOR WILKEN, referring to Page 4 of the PowerPoint Presentation, noted that the producer is required to supply a minimum of four flanges and asked if "no local supply obligations" means that the producer or the shipper does not have to make gas available at the flanges.

9:05:13 PM

MR. BARNES replied that to his understanding, there is no obligation to supply the local market [with gas]. Many PSC's around the world require all producers to provide the proportionate share of the local demand. However, there is no provision in the proposed contract requiring the producers to do so. He surmised that the state is free to sell its gas.

9:06:17 PM

MR. SHEPLER agreed that this is correct. He quoted from Article 9.4 of the contract which reads in part:

> Any *Party* may supply *Gas* to *Alaska* purchasers, but no *Party* is required to sell *Gas* to an *Alaska* purchaser.
>
> An existing *Shipper* transporting *Gas* out of *Alaska* my choose to make *Gas* deliveries to *Alaska*, so long as that *Shipper* continues to satisfy its shipping commitments outside of *Alaska*.

MR. SHEPLER explained that while there is no obligation in the contract in regard to where the gas is sold, the gas may be sold to the highest market.

9:07:35 PM

REPRESENTATIVE BETH KERTTULA, Alaska State Legislature, inquired as to whether the consultants have ever seen a contract in which the only remedy [for disputes] is termination.

9:08:00 PM

MR. SHEPLER, MR. BARNES, and MR. HARPER all replied no.

REPRESENTATIVE KERTTULA asked for clarification as to whether the consultants have seen a contract with a similar diligence requirement.

MR. BARNES, MR. SHEPLER, and MR. HARPER all replied no.

REPRESENTATIVE KERTTULA, regarding the indemnification of municipal taxes, asked if the consultants have seen a contract with similar provisions.

MR. BARNES replied that he has not seen a proposal as comprehensive as the fiscal contract. He has seen contracts which include an indemnification mechanism as a way to establish fiscal certainty.

REPRESENTATIVE KERTTULA asked how the contract would affect the bidding on future leases.

9:09:46 PM

MR. EASON replied that all related initiatives currently under consideration, including the PPT, will factor into each companies analysis of how to approach competitive bidding. He surmised that the companies would see this as beneficial, and would depend on individual strategies and considerations.

REPRESENTATIVE KERTTULA, in regard to access to the pipeline, opined that losing [access] at the FERC would not be beneficial.

MR. SHEPLER replied that currently, the one issue on appeal from the FERC is whether it can order the initial design to be made larger. If this appeal is lost, the remainder of the rule-making would still stand. He noted that the states goals of building and expanding the pipeline will be driven by the LLCs decisions, requirements, and incentives to expand.

MR. EASON added that generally, the expansion provisions will be uniform. He stated that concerns regarding access will factor in to bidding decisions in areas that are known to be more “gas prone.”

9:12:23 PM

MR. SHEPLER said:

> You will be hearing ... from the constituency, that the state has been trying to protect in this process. We've simply been the spokesman so far, or one of the spokesman, for this issue of access and expansibility. It's really not ours, or ... yours, it's their issue to carry forward on.

9:12:55 PM

REPRESENTATIVE KERTTULA opined that this was a lesson learned from the Trans-Alaska Pipeline System (TAPS), that is, in some ways, playing out again.

SENATOR THERRIAULT added that when the application was provided to the FERC, there was a unified voice from the Administration, the Legislature, and the independent companies, requesting favorable treatment. This included a request that the line be developed to foster competition and expansion.

MR. SHEPLER noted that there is a clear congressional policy set forth in the 2004 statutes which states that the FERC open season rules, broadly defined, are required to facilitate the exploration, development, and production of the North Slope reserves.

SENATOR THERRIAULT remarked that the rolled-in pricing is a rebuttable presumption and is not locked in.

9:14:21 PM

REPRESENTATIVE SEATON requested a comparison of the cost to take the gas in a marketable condition versus taking the gas upstream and "dirty." He asked to have this defined as a percentage of the states tax rate. In addition, he requested an international comparison of the credits, expenses, and taxes included in the contract, excluding the royalties.

MR. BARNES replied that he is unable to give a quantitative answer at this time, adding that to his knowledge, this has not been addressed.

MR. EASON said:

> I don't think you are going to find anything in the world like this contract. Because ... as the administration has told you ... and Dr. Van Meurs, I believe has confirmed ... all of his comparisons ...

are ... of a very limited area and how the parties are going to share the resource. That ... is defined in part by how they are going to bear cost, if any, between the host government and the producers. They are done specifically tailored to a project. In this case, what you're being asked to do, in the totality of the package, is to take a number of steps to [complete] this project. They [may] include changing severance tax provisions to a net profits tax ... which is an extraordinarily large decision, with fiscal implications which will become more apparent as time plays out. Because, all you have now are a series of models that tell you ... the range people think will be of the cost and revenues and the taxes that [the state] will receive as a result. Nobody can predict with any certainty there. But, you're applying it across the board, statewide. That's a part of the calculus.

And then, you're also providing ... a list, which isn't complete yet (by any means, I can't certify this) of other known fiscal incentives that are built into the contract itself. And they cover the North Slope, rather than a project. They cover all the existing fields and units and will cover things that have yet to be discovered. By definition, they are going to cover things ... in total quantity, production-wise. Much more than the gas you have today. You're looking at a package of provisions and then being asked for fiscal certainty. I don't think that ... if you ask Dr. Van Meurs in that context, he can point to anything in the world that rivals that in scope or inclusion. So, I don't think there's going to be a meaningful way to compare it to anything.

REPRESENTATIVE SEATON noted that all the previous comparisons have been for oil, pointing out that the gas would be taxed at one-third of the oil rate with identical credits. He said that while the legislature has been informed that dollars made from gas are worth less than those made from oil, it has not seen any comparative modeling to show the result in regard to gas.

9:22:04 PM

SENATOR THERRIAULT stated that EconOne is working with PFC Energy (PFC) to gather this information. In addition, he said, there is limited information from Wood Mackenzie regarding tax

rates in different jurisdictions. He noted that this report is not available to the general public; however, it can be made available to legislators.

9:22:49 PM

SENATOR THERRIAULT, referring to the PP Presentation, which shows international comparisons, asked if the areas which offer stabilization and certainty have very strong reversionary language. He said:

> So, we have heard that ... this contract has the strongest work commitments of any contract around the world. But in many of those areas, because you've got very strong reversionary language, the clock is ticking. And if you don't move something to production, by the ticking of the clock, you're going to lose it. And so that's the motivator.

MR. BARNES replied that it is a combination of things, noting that the highest motivator is to reach a development decision within the primary term. In a lease environment, he said, once production has started, the contract is held by production indefinitely, as long as there is production in paying quantities. In regard to the national jurisdictions, he said, there is a "marked difference" in the paradigm of the international governments to control the national patrimony. He agreed that these governments do not want the investor to "warehouse" the assets, and therefore these agreements are quite restrictive. For example, he said, after the first four years, the investor must give back a quarter of the original acreage. At the end of the term, the investor must give back all acreage that is not being utilized. This focuses the mind of the investors when confronted with the timeline requirements; however, the governments do make exceptions when difficulties arise.

9:26:44 PM

REPRESENTATIVE PEGGY WILSON, Alaska State Legislature, asked if the removal of impurities occurs at separate locations.

MR. EASON offered his understanding that the in-kind taking was one of the first decisions made, with the other provisions accommodating this. He said that the contract contains provisions which contemplate an integrated facility, stand-alone facilities, or, if for multiple fields, there may be several

facilities at one field and additional facilities further down stream. There are, he said, solutions for each issue. He opined that the practicality of making changes to these elements is a question that can only be answered by the administration.

9:29:37 PM

MR. HARPER added that the contract contemplates a natural gas liquids study, and the way in which the study plays out is important to the state as a minority interest holder. He stated that the vote regarding how minority interest holder rights are administered and decision making in terms of how studies are done, what choices are made as a result of the aforementioned study, and how information is or is not disseminated is vital.

9:30:32 PM

SENATOR THERRIAULT said:

> Can you give us a ... quick primer on production of oil and gas from the same reservoir? I'm sure there's an ideal point at which you've ... squeezed out as much oil as you can, you're reinjecting gas to flush more oil out. But before you get that last drop of oil, there's probably a point at which you'd want to start producing both. Otherwise, you run the risk of ... losing value from the total mix of hydrocarbons. I'm just wondering is there any general rule of thumb or [is it] different from field to field? Then, if you can expand a little bit into ... recycling in excess of eight Bcf of gas a day, is there any idea of at what point we will have flushed out as much oil as possible, and ... we ... get to a point that we might be losing value from the total hydrocarbon mix, by not delivering gas from the fields in question.

MR. EASON replied that every field is unique and said:

> Obviously with large fields like Prudhoe Bay, there is generally a tremendous amount of effort to answer that question, that begins early and continues throughout the life of the field. But, generally speaking, ... as you've seen historically, as you produce and reinject the gas, you have to continue to make very large investments – expansions of your injection capability – simply to keep up. Because, as production goes, through the years, you get more [gas

and water, among other things] with the oil, per unit volume of oil, and you've got to dispose of them or reinject ... to ... maintain the reservoir pressure and to ... handle those things. The Alaska Oil and Gas Conservation Commission (AOGCC) obviously has the primary responsibility of trying to make sure that those things are done properly [and must consider the timing]. But the producers certainly have, as I said, a continuing model for Prudhoe Bay. It would be, I'm sure, a very, very complex model, because it is ... a relatively complex reservoir. There are many fault segments throughout the reservoir and – I don't want to say that it's uniquely complex, because it's not – but there are lot's of unknowns that [must be] addressed by testing and modeling in a continuous manner. But, it is certainly true that you are approaching ... a point where the value of the gas is going to ... have to be recognized, and it's a balancing act between the timing for how much you're having to invest, to get the oil out, and how much response you're getting for that, how much timing is involved in doing it. And that decision is going to have to occur.

I think that most people I've talked with believe that [the legislature] is approaching that. Some people would say that in the timeframe of the project that's proposed, you're there. I think there are ... some folks that could provide you with as good an answer as you're going to get for that, independently of the producers.

9:34:39 PM

REPRESENTATIVE HARRY CRAWFORD, Alaska State Legislature, asked how the 7.25 tax amount compares to international agreements.

MR. EASON replied that he does not have personal experience with international agreements.

MR. BARNES stated that he has not seen tax gas, per se. He opined that there is not a consistent pattern on severance taxes. Typically, he said, when an investor makes a "new country entry," it will evaluate the entire fiscal and commercial package as part of the transaction.

REPRESENTATIVE CRAWFORD clarified that his intent was not to inquire about the "consistency," but rather to understand if the 7.25 amount is a generous amount or a low amount.

MR. BARNES replied that he has not looked into this.

REPRESENTATIVE CRAWFORD requested access to this information if it is available.

SENATOR THERRIAULT offered his understanding that EconOne is working on this, and added that there may be information in the Wood Mackenzie study, as well.

9:37:51 PM

SENATOR THERRIAULT remarked that the companies involved in the proposed contract enter into agreements with one another often. He inquired as to whether these agreements are generally long-term, and if so, if the contracts include periodic reopeners, and what type of metrics trigger the reopeners.

MR. BARNES asked for clarification as to the type of agreement in question.

SENATOR THERRIAULT replied that his question was in regard to developing a field where there is joint ownership, or a pipeline project.

MR. BARNES stated that typically, the principal agreement would be a joint operating agreement, which includes a decision-making mechanism. He said that an individual investor would like to make unilateral decisions which would be followed by the other party; however, this doesn't occur often. Usually, there is a "super majority" decision making level, which may say "two or more non-affiliated parties having 65 percent of the interest in the field." He explained that this means a party having more than a 35 percent interest would have a "blocking vote," which means they may stop a decision, but do not have the affirmative ability to "carry something forward." He went on to say that the fall-back for most decision making mechanisms is for the companies to have a blocking vote. The typical range of "pass mark" decision making is 60-75 percent and includes two parties. This may leave a concern that a 20 percent voting share, would not give the state a blocking vote.

MR. HARPER agreed and added that there is flexibility built in to the joint operating agreements, including opportunities for

non-consent. The parties have the opportunity not to participate, with the participating parties then earning beyond what they would normally. There are also opportunities to replace the operator, and reconsider different processes over time.

MR. SHEPLER, in regard to the pipeline, said:

> There are occasional joint owners in the pipeline – potentially competing pipelines – that ... are forced [for] one reason or another to jointly own a piece of the tube. And in those contexts, there are what are called 'sole-risk' provisions, which allow one party to expand the pipeline on their own investment, even if the other party – the joint owner – is disinclined. Again, they are not common, but they do exist.

SENATOR THERRIAULT, in regard to the contract being created using a Delaware LLC, asked for a comparison of Delaware versus Alaska and what might be gained or lost.

MR. SHEPLER replied that his understanding of this is very minimal. He stated that the LLC for the midstream element is going to be a Delaware LLC. Alaska's LLC statute, he said, requires a much higher "duty of care" from the entities making up the LLC than does a Delaware LLC.

9:44:48 PM

SENATOR THERRIAULT announced that his staff is working with Representative Samuels' staff to have all questions and answers sent out to all legislators. In addition, he said, an inquiry has been made to the Administration regarding what past emails and memos need to remain confidential.

9:46:19 PM

ADJOURNMENT

The Legislative Consultant Availability was concluded at 9:46:55 PM.