

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

March 23, 2007

8:32 a.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Kurt Olson, Vice Chair
Representative Nancy Dahlstrom
Representative Jay Ramras
Representative Ralph Samuels
Representative Mike Doogan
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Craig Johnson
Representative David Guttenberg
Representative Berta Gardner

COMMITTEE CALENDAR

HOUSE BILL NO. 177

"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 177

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

03/05/07	(H)	READ THE FIRST TIME - REFERRALS
03/05/07	(H)	O&G, RES, FIN
03/06/07	(H)	O&G AT 3:00 PM BARNES 124
03/06/07	(H)	-- MEETING CANCELED --
03/08/07	(H)	O&G AT 3:00 PM BARNES 124
03/08/07	(H)	-- MEETING CANCELED --

03/13/07	(H)	O&G AT 3:30 PM HOUSE FINANCE 519
03/13/07	(H)	Heard & Held
03/13/07	(H)	MINUTE(O&G)
03/15/07	(H)	O&G AT 3:00 PM BARNES 124
03/15/07	(H)	Heard & Held
03/15/07	(H)	MINUTE(O&G)
03/19/07	(H)	O&G AT 8:30 AM CAPITOL 106
03/19/07	(H)	Heard & Held
03/19/07	(H)	MINUTE(O&G)
03/20/07	(H)	O&G AT 3:00 PM BARNES 124
03/20/07	(H)	Heard & Held
03/20/07	(H)	MINUTE(O&G)
03/21/07	(H)	O&G AT 5:30 PM SENATE FINANCE 532
03/21/07	(H)	Heard & Held
03/21/07	(H)	MINUTE(O&G)
03/22/07	(H)	O&G AT 3:00 PM BARNES 124
03/22/07	(H)	Heard & Held
03/22/07	(H)	MINUTE(O&G)
03/23/07	(H)	O&G AT 8:30 AM CAPITOL 106

WITNESS REGISTER

MARTIN MASSEY, U.S. Joint Interest Manager
ExxonMobil Corporation
Houston, Texas

POSITION STATEMENT: Testified on ExxonMobil Corporation's position on HB 177 and answered questions.

PATRICK GALVIN, Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Addressed ExxonMobil Corporation's presentation on HB 177 and answered.

TOM IRWIN, Commissioner
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Answered committee questions on resource issues.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at [8:32:35 AM](#). Representatives Doogan, Olson, Dahlstrom, Samuels, and Kohring were present at the call to order. Representatives Ramras and Kawasaki arrived as the

meeting was in progress. Also present were Representatives Johnson, Guttenberg, and Gardner.

HB 177-NATURAL GAS PIPELINE PROJECT

8:32:51 AM

CHAIR KOHRING announced that the only order of business would be HOUSE BILL NO. 177, "An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

8:33:06 AM

MARTIN MASSEY, U.S. Joint Interest Manager, ExxonMobil Corporation, explained that his position has responsibility for the commercialization of gas resources for ExxonMobil in Alaska. He reminded the committee that ExxonMobil has been a key player in the development of Alaska's oil resources for over 50 years, and holds the largest working interest in Prudhoe Bay. He went on to say the gas pipeline project has the potential to produce billions of dollars in revenue and to provide a stable and secure source of gas for the state and North America for decades to come. He opined that the project could add as much as 1 billion cubic feet a day to ExxonMobil's gas sales. He relayed that his company is interested in continuing to work with the state to move the Alaska gas pipeline project forward. He offered his belief that this project is a "world scale" undertaking with significant costs and risks. He relayed that due to recent increases in construction costs, the 2001 cost estimates of \$20 billion for pipeline construction are too low. Furthermore, natural gas prices remain highly volatile and are now slightly less than those in 2001. Other key factors include cost overruns, regulatory delays, construction conditions, and state fiscal uncertainties. The large size of the project effects costs and increases the complexity of the project. He cautioned that size also amplifies the consequences of poor execution.

8:36:30 AM

MR. MASSEY explained that large, commercially sound oil and gas pipeline projects have traditionally been able to obtain financing where there are strong sponsors, proven track records, and financial strength sufficient to provide sponsor equity. He

opined that the key project commitments for the Alaska gas pipeline project will take the form of long-term gas transportation commitments. Firm transportation (FT) commitments are binding obligations made by shippers to pay for the cost of reserving a quantity of gas for a pipeline over a specified period of time. In this case, the producers would be the shippers. He relayed that FT commitments are usually made during open season, and that according to Federal Energy Regulatory Commission (FERC) order 2005 for the Alaska gas pipeline, must be for at least 90 days. During that time, any or all gas shippers can make binding commitments for a specific volume of transportation capacity, he explained. He stated that FT commitments are needed for financing and may be for billions of dollars. The shipper is required to pay its commitment regardless of whether the gas is actually shipped and regardless of the gas market price. He opined that due to this system, the development costs and associated overrun risks are ultimately borne by the shipper. He stated it is ExxonMobil's view that the parties taking the risk need to be able to manage the risk. He offered his opinion that the producers as shippers cannot make FT commitments during open season unless they are confident the gas pipeline project can be built cost effectively and operated on a commercially viable basis. He opined that due to the large size of the project, only a limited number of companies can demonstrate the capability and financial strength necessary to effectively participate in and manage a project of this size. He offered that the producers have experience and history in meeting project objectives on a worldwide basis. He noted that ExxonMobil has project experience worldwide and that its development costs tend to 25 percent lower than the industry average when calculated on a dollar per barrel basis. He said that ExxonMobil has a record of completing large projects within 15 percent of the costs estimated at the time of project funding. He opined that combining ExxonMobil's capability with that of ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc., will provide the best chance for delivering a successful project.

[8:46:06 AM](#)

MR. MASSEY went on to explain that the producers have over 40 years of worldwide experience in oil and gas exploration in northern climates. He noted that many innovations were developed by ExxonMobil for use in cold weather exploration and production. He attributed his company's success to long term research, technical development, and a firm commitment to improve the efficiency and safety of its operations. He

explained that technology is of great importance in this industry, and that ExxonMobil invests a significant amount in the development of new technologies.

8:49:20 AM

MR. MASSEY stated that it is important to remember that the Alaska gas pipeline project is a basin-opening project that will benefit the state and the oil and gas industry. He offered that worldwide, basin-opening projects are most successful when there is alignment between the host government and the lease holders. He offered that for this project that means the state and ExxonMobil, BP Exploration, and ConocoPhillips. He opined that a producer-state gas pipeline project will produce the most revenue for the state as those parties have the maximum incentive to control costs, which will ultimately result in a higher net-back price for gas. The state will receive the majority of its revenue from the value of the gas, he said. He opined that third-party owners do not share the same incentives because they can actually benefit from increased capital costs.

MR. MASSEY said that due to the numerous costs and risks, ExxonMobil requires fiscal terms that are predictable and durable to proceed with this project. He relayed that ExxonMobil is willing to take the geology, cost, and commodity price risks. However, ExxonMobil cannot take the risk of a change in fiscal terms, he said. He explained that his company has developed an industry-leading approach for management of geology and cost risks. He also noted that market risk is inevitable and within his company's management expertise. In contrast, fiscal risk is "totally outside our control," he opined. He emphasized that ExxonMobil must have agreements which will allow it to develop this "mega-project" in predictable and durable terms so that it can make an adequate investment decision. He offered that if fiscal terms are subject to future changes, ExxonMobil cannot make a well-founded investment decision on behalf of its shareholders. Due to the large amount of investment required to develop the gas pipeline, he opined that increases in taxes on oil and gas related activities during the life of the project could significantly impact the commercial viability of the project.

8:53:38 AM

MR. MASSEY opined that AGIA does not offer the fiscal stability necessary for the project because it allows for modification of fiscal terms. He suggested that development of a predictable

and durable fiscal framework means that the terms to be agreed on between the state and the producers recognize the magnitude and risks associated with the project; balance state and producer needs, and provide for calculation of the "total state take" in a transparent and predictable manner. He offered that AGIA must bring together upstream and midstream concerns because "the upstream pays for the midstream." Upstream means "the revenue generated from the sale of the gas and liquids from the pipeline project," he explained. In order to calculate the revenue from the upstream, his company must have clarity on the taxes and royalties, which must be set at a level to make the project viable. He said that this must be done at the beginning of the project to insure a viable project. He went on to say that any proposal must demonstrate how a successful open season will be achieved.

MR. MASSEY opined that AGIA should allow applicants to define how they could achieve the state's objectives, rather than prescribing specific requirements that must be met. He suggested that AGIA offer broad key objectives and allow the applicants flexibility in meeting those objectives. For example, he said that ExxonMobil would prefer that the applicant determine whether it wants any capital contribution from the state.

[8:57:07 AM](#)

MR. MASSEY warned that shippers may be unwilling to commit to FT commitments if there is a substantial likelihood that their initial rates will be significantly increased in the future to accommodate pipeline expansion. He offered his belief that the terms of the federal Alaska Natural Gas Pipeline Act strikes the proper balance between encouraging initial investment and encouraging exploration by providing an opportunity for future access to the pipeline. He opined that FERC approved of "unprecedented policies" to enable a FERC-mandated expansion to benefit explorers. He opined that issues of how potential future shippers may access the pipeline and future pipeline capacity should be administered by FERC. He noted that expansion costs can be very high, up to \$500 to \$800 million per year.

[8:58:29 AM](#)

REPRESENTATIVE RAMRAS asked about the calculation of roll-in rates in determining additional expansion costs.

MR. MASSEY explained that the increased costs are calculated by rolling the increased costs into the tariff rate to market, multiplied by the volume of gas shipped.

REPRESENTATIVE RAMRAS asked about the aforementioned calculation in the situation where ExxonMobil discovers additional gas for inclusion in the pipeline; specifically, whether the company would benefit from an increased roll-in rate in that situation.

MR. MASSEY agreed with the aforementioned point, but offered that situation should not be mandated, but left open for agreement by the stakeholders, or for negotiation with FERC. He offered that FERC is capable determining what is in the best interest of all parties.

MR. MASSEY explained in response to a question that this decision is not for the state or legislature. He said FERC has the authority to make the decisions regarding pipeline expansion regardless of "what we write in our contract"

[9:02:07 AM](#)

MR. MASSEY suggested that the proposed upstream inducements in AGIA require significant modification to ensure that a commercially viable project is obtained. He offered it would be preferable to leave that issue open and allow an applicant to make a proposal to address those necessary terms. He opined that the timelines set forth in AGIA are not conducive to good project management and indicated that a commercially viable project will proceed at an appropriate pace under producer management.

[9:02:59 AM](#)

REPRESENTATIVE SAMUELS questioned how to assure that the work will commence without some type of timeline.

MR. MASSEY opined that asking for something that "doesn't make sense" will never work, particularly on a project of this size. He offered that the appropriate standard is to be diligent, and that failure to be diligent could result in loss of the contract or other remedy.

MR. MASSEY continued by stating that AGIA lacks specifics on key fiscal terms and other requirements. He opined that the discretion given the commissioners of DOR and DNR creates significant uncertainty. He further opined that AGIA's failure

to provide specific criteria for selecting the successful bidder may lead to litigation from project proponents not selected for inducements. He said that the project should provide for binding neutral arbitration as a mechanism for dispute resolution. He characterized arbitration as a successful and recognized method of dispute resolution.

[9:07:13 AM](#)

MR. MASSEY concluded by paraphrasing from written testimony [original punctuation provided]:

In closing, I would like to reiterate that ExxonMobil is committed to moving the gas project forward. Our company possesses the financial strength and project experience required to make this project a success. We are ready to work with the Administration and the Legislature to establish a framework that recognizes the integrated nature of the project and mitigates the risks I have discussed to allow the project to progress. We would suggest AGIA be amended to include the broad objectives the State wants to achieve and allow each applicant to decide how best to meet those objectives and to identify what is required from the State to advance the project. The State can then accept the proposal that delivers the most value. We are ready to participate in a competitive open transparent process under the approach I have outlined.

[9:08:39 AM](#)

REPRESENTATIVE RAMRAS expressed his desire to move AGIA and offered that he appreciates the efforts of ExxonMobil and other producers to work towards development of a gas pipeline.

[9:13:16 AM](#)

REPRESENTATIVE DAHLSTROM asked how much ExxonMobil spent in Alaska in 1992.

MR. MASSEY estimated capital investment in Alaska at about \$150 to \$200 million per year. He noted that his prior statement regarding investment of \$3 billion was related to investment in technology.

REPRESENTATIVE DAHLSTROM asked whether any technology related to the thermal model upon which Trans-Alaska Pipeline System (TAPS) was based on is still under patent protection.

MR. MASSEY noted that since TAPS was built quite a few years ago, the technology used then is out-dated. He commented that ExxonMobil judges bids as a part of its business and stated that his company first determines whether the bidder is able to do the work. To make that determination, it reviews the applicant's financial strength, project experience, safety, and environmental compliance records. He opined that in this instance, the ability to deliver a successful open season is the key to project success. He opined that the second criteria would be to determine the proposed project's value to the state. The third issue would be to consider how the applicant proposes to meet objectives of providing gas for in-state use, local hire and other factors.

[9:18:26 AM](#)

REPRESENTATIVE DAHLSTROM asked for further clarification regarding the issue of fiscal uncertainty.

MR. MASSEY replied that AGIA does not provide the predictable and durable terms to make the project commercially viable. Of particular concern are the taxation factors that will affect upstream values, he explained. He said that applicable property and state income taxes are not "well defined." He said that the goal is to define how to allocate revenues for the life of the project. He reiterated that ExxonMobil will take on the risks of price, geology, and cost, but not the risk that the fiscal terms will change.

[9:20:30 AM](#)

REPRESENTATIVE DAHLSTROM asked what would give the assurance of predictability.

MR. MASSEY reiterated that the applicants be allowed to describe their project approach, which the state can then review to determine which project is best.

REPRESENTATIVE DOOGAN asked whether the witness is suggesting a process whereby license applicants will propose a tax and royalty structure for the project.

MR. MASSEY agreed with the aforementioned summation. He opined that the petroleum profits tax (PPT) as currently in AGIA is too high for a successful project and suggested applicants be allowed to submit proposed rates for the project, which the state can evaluate to determine which proposal is most favorable to the state.

[9:23:35 AM](#)

REPRESENTATIVE DOOGAN asked how a non-producer could advise the state as to what the producers' tax and royalty rates should be.

MR. MASSEY stated that pipeline companies understand economics and project viability and could approach ExxonMobil to determine a rate to make their project viable. He went on to say that if a pipeline company did not feel like a producer was dealing with them fairly, the pipeline company could suggest its own proposal for a successful open season.

REPRESENTATIVE DOOGAN expressed some skepticism with the aforementioned scenario since the competitors will be asking for a key piece of information from ExxonMobil.

MR. MASSEY stated that it is obvious what ExxonMobil needs to progress the project. He reiterated that companies can make their own proposal. He agreed that the party with the lease has a competitive advantage, and that there need to be assurances the advantage is not mis-used.

[9:26:25 AM](#)

REPRESENTATIVE DOOGAN clarified that under the proposal suggested, the commissioners would review the proposals, pick a licensee, and then come before the legislature to finalize the tax and royalty regime as spelled out in the proposal.

MR. MASSEY agreed with that characterization. He opined that there should be enabling legislation to allow this approach to proceed.

REPRESENTATIVE DOOGAN asked about other entities that may help provide fiscal certainty for tax and royalty payments.

MR. MASSEY stated that ExxonMobil's business practice is to discuss and resolve the project terms with the resource owner, in this case the State. He agreed that there are other interested governmental units, but the state of Alaska is the

resource owner and it is imperative that the resource owner and the lease holder come to terms to make the project viable.

REPRESENTATIVE DOOGAN asked if ExxonMobil is asking other taxing authorities to freeze their tax rates for this project.

MR. MASSEY replied that Alaska is the only entity because it is the resource owner.

9:31:01 AM

REPRESENTATIVE SAMUELS asked whether there are concerns about the possibility that Canada will increase its property taxes. He also asked about the tax situation that applies to federal property.

MR. MASSEY replied that while ExxonMobil would like the Canadians to put a reasonable tax on the project, he noted that the Canadian piece is relatively small, so a tax increase would not have the same negative impact on the project. Furthermore, since the federal government is not the resource owner at Prudhoe Bay and Point Thompson, his company does not consider it appropriate to request some sort of long-term fiscal terms related to the project.

9:33:00 AM

REPRESENTATIVE SAMUELS asked whether ExxonMobil could ship gas to market if the company's partners do not want to bid gas to ExxonMobil's pipeline.

MR. MASSEY stated that his company believes that to be successful, this project requires the participation and alignment of the state, ExxonMobil, BP Exploration, and ConocoPhillips. He stated there is the ability for an owner in Prudhoe Bay to take its own gas, although it is complicated and requires agreement of other owners.

9:35:45 AM

REPRESENTATIVE SAMUELS asked why Alaska was being asked to make concessions that are not being requested from taxing authorities in other areas where ExxonMobil has operations.

MR. MASSEY reiterated that the gas pipeline is a basin-opening project and said that worldwide, basin opening projects require alignment of the resource owner and the lease holders. He

emphasized that the upstream pays for the costs of the infrastructure investment required in basin-opening projects. He further reiterated that these projects require the developer to take on great deal of risk and cost and that given the risks involved, the risk-takers need to be able to manage that risk.

REPRESENTATIVE OLSON asked what the current project cost estimate is for the gas pipeline.

MR. MASSEY stated it is difficult to estimate project cost at present, but opined that costs to Chicago would be over \$30 billion.

REPRESENTATIVE OLSON asked the witness to address the \$500 million incentive provided in AGIA and whether there has been any contact with First Nations peoples.

MR. MASSEY opined that the \$500 million incentive is not much of a leverage incentive in a project of this magnitude. He went on to suggest that the applicant propose what incentives are necessary to make the project viable. As to First Nations' peoples, he noted that ExxonMobil has primarily focused on the federal government in considering Canadian issues. He offered that it is not appropriate to begin discussion until there is a project.

[9:41:24 AM](#)

REPRESENTATIVE RAMRAS asked about the criteria ExxonMobil suggests be considered in determining the gas pipeline lease award.

MR. MASSEY reiterated his opinion that the first criteria should be to consider whether the applicant has the financial strength to complete the project. The state should consider the applicant's past project experience and results, as well as the applicant's safety and environmental performance. Furthermore, the state should examine how that applicant will ensure a successful open season. Secondly, the state should consider overall value to the state. Last, the state should consider other objective, such as in-state access to gas and local employment.

[9:46:54 AM](#)

REPRESENTATIVE DOOGAN asked whether the applicants should propose tax and royalty rates for both oil and gas.

Furthermore, he asked about the company's prior known position on this issue in the Stranded Gas Development Act (SGDA).

MR. MASSEY agreed that ExxonMobil's position is that the applicants propose the tax rates. He agreed that the company's position on the SGDA is one example of what would be needed for project success, although he offered it is not the only example.

9:50:09 AM

PATRICK GALVIN, Commissioner, Department of Revenue, stated that ExxonMobil Corporation is a very successful company and has presented a consistent position to the state on various oil and gas resource matters throughout the years. He opined that the suggestions made regarding AGIA are consistent with the company's prior approach, and more like the model of the SGDA. He opined that the state has proposed evaluation criteria consistent with that suggested by ExxonMobil. He offered that any requirement that an applicant ensure a successful open season limits the award of the gas pipeline project to those "with the gas." He stated that DOR is not expecting an applicant to be able to come in and insure that there will be a successful open season. However, he opined that the state has a choice to go the route as suggested by ExxonMobil, or to take a different path "which puts us in a different place in a year or two from where we are today."

9:56:20 AM

REPRESENTATIVE RAMRAS referenced concerns about whether the volume of gas available is sufficient for a gas pipeline to Canada.

TOM IRWIN, Commissioner, Department of Natural Resources (DNR), noted that prior negotiations had been somewhat closed.

COMMISSIONER GALVIN replied that the state does not know how much gas is available at present and there is no current request before the Alaska Oil and Gas Conservation Commission to examine the effect of different off-take volumes. However, he opined that between the Point Thompson and Prudhoe Bay units, there will be the opportunity to take off gas, but stated that this does need to be examined more closely.

MR. IRWIN responded to a question by explaining that DNR is working with committee on the issue of appropriate criteria to be used in evaluating proposals.

[10:01:05 AM](#)

REPRESENTATIVE SAMUELS noted that there are some concerns about how to evaluate bids, especially if they meet all criteria but one, yet that applicant has access to the gas.

MR. IRWIN responded that many issues have been considered, and noted that the companies have significant business experience that will help them design an approach to move the project forward.

[10:04:49 AM](#)

COMMISSIONER GALVIN offered that as a public entity, the state has some limitations on its approach because it must make a collective decision on how to move forward. He said that it is incumbent on the state to make sure the requests are commercially reasonable and that they solicit commercially reasonable responses. He recognized there are many factors to consider in project planning, therefore the state has attempted to establish a general framework for what is necessary for project participation.

[HB 177 was held in committee.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [10:08:30 AM](#).