ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
February 14, 2007
1:58 p.m.

MEMBERS PRESENT

Representative Carl Gatto, Co-Chair
Representative Craig Johnson, Co-Chair
Representative Vic Kohring
Representative Bob Roses
Representative Paul Seaton
Representative Bryce Edgmon
Representative David Guttenberg
Representative Scott Kawasaki

MEMBERS ABSENT

Representative Peggy Wilson

COMMITTEE CALENDAR

OVERVIEW: DISCUSSION OF A PRODUCER-OWNED GAS LINE WITH BRITISH PETROLEUM, CONOCOPHILLIPS, AND EXXON

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

M. E. (MARK) NELSON
U.S. Joint Interest - Alaska
ExxonMobil Production Company (ExxonMobil)
Houston, Texas
POSITION STATEMENT: Assisted in presenting an overview in support of a producer-owned gas pipeline.

CRAIG HAYMES, Production Manager - Alaska
ExxonMobil Production Company (ExxonMobil)
Anchorage, Alaska
POSITION STATEMENT: Presented an overview in support of a producer-owned gas pipeline.

DAVID VAN TUYL, Gas Commercialization Manager

BP Exploration (Alaska) Inc. (BP)
Anchorage, Alaska
POSITION STATEMENT: Presented an overview in support of a producer-owned gas pipeline.

WENDY KING, Director of External Strategies
ConocoPhillips Alaska, Inc. (ConocoPhillips)
Anchorage, Alaska
POSITION STATEMENT: Presented an overview in support of a producer-owned gas pipeline.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at 1:58:57 PM. Representatives Gatto, Seaton, and Roses were present at the call to order. Representatives Guttenberg, Edgmon, Kawasaki, and Kohring arrived as the meeting was in progress.

OVERVIEW: DISCUSSION OF A PRODUCER-OWNED GAS LINE WITH BRITISH PETROLEUM, CONOCOPHILLIPS, AND EXXON

2:00:04 PM

CO-CHAIR GATTO announced that the only order of business would be an overview discussion of a producer-owned gas line with BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Production Company.

2:00:23 PM

M. E. (MARK) NELSON, U.S. Joint Interest - Alaska, ExxonMobil Production Company (ExxonMobil), introduced Mr. Craig Haymes.

CRAIG HAYMES, Production Manager - Alaska, ExxonMobil Production Company (ExxonMobil), paraphrased his presentation from the following written statement [original punctuation provided]:

> Good afternoon Representative Gatto, Representative Johnson and members of the House Resources Committee. My name is Craig Haymes. I recently moved to Alaska from ExxonMobil Canada, where I had been involved with arctic oil and gas developments and operations for the past 4 years. I have assumed the role of ExxonMobil Production Manager for Alaska, replacing Richard Owen. Although I've only been here a short while, it is obvious that this state has a lot to offer. My family

and I are really excited to have the opportunity to live and work in Alaska.

Mark Nelson joins me today. Mark has worked on our Alaska team for many years in different capacities and during the past 3-4 years, has been part of the Alaska Gas Commercialization team. He has been active in the fiscal negotiations.

Thank you for the opportunity to discuss the important issue of Alaska gas commercialization.

The Alaska Gas Pipeline project is important to Alaska, to ExxonMobil, and to our nation. The Project has the potential to generate billions of dollars in revenues for the State of Alaska, the U.S. federal government, and Canada, and could provide a stable and secure source of clean energy for Alaska and North America for decades to come. Let me assure you that EM is ready to work with Governor Palin and her cabinet and the Legislature to move forward on Alaska gas pipeline development.

To demonstrate the project's significance to EM, let me provide a few numbers. This project has the potential to add over 1 billion cubic feet per day (EM share) of gas sales for EM, which is more than a 10% increase to our current daily gas production. The Project could also add over 1 billion oil equivalent barrels of proved reserves – nearly enough to replace a full year of our production. Given the significant impact this project could have on our business, we are obviously very interested in progressing it.

EM has spent more than $180 million studying ways to commercialize Alaska gas. Since the 1970's we have evaluated LNG, gas to liquids and gas pipeline alternatives. Based on our studies, including those with BP and ConocoPhillips, we have determined that a Producer gas pipeline project will result in the best value for the State, the Producers and the nation.

Because of the time and resources that EM and many others have devoted to progress Alaska gas development, we are disappointed that these prior efforts have not resulted in a way to move forward.

Nevertheless, we made significant progress last year in developing a fiscal framework necessary to progress the project. However, we recognize that we must address the issues identified in the public comments to the satisfaction of the State and the Producers. We are ready to engage in a process to address these concerns and will do this in a manner that involves the Legislature.

We understand the Governor is currently considering proceeding under an RFP process. We have expressed our thoughts to the Governor and are hopeful a process that will lead to a successful result will be developed. We believe it is important that the process not foreclose any options…flexibility is very important.

Let me take a few minutes to discuss the magnitude of this project and the associated risks.

Because this project appears to be "simply" a gas treating / gas pipeline project, the tendency exists for all of us to underestimate the size, magnitude and risks associated with it. The Alaska Gas Pipeline Project is a world-scale undertaking with significant risks. In fact, the Project will be the largest private investment in North America – significantly larger than most "model" worldwide oil and gas "mega" projects. There is not really a project that compares.

Because of this size, many factors impact commercial viability.

First there is cost:

Our previous estimate of $20 billion ($2001) is now substantially higher. Since 2001, steel prices have nearly doubled. Industry and construction labor costs are experiencing hyperinflation. In addition, world-wide mega-projects are placing pressure on global materials, contracting services and skilled manpower.

Next there is gas price:

Despite recent increases, natural gas prices remain highly volatile. The price before 2000 was less than the estimated project toll.

Finally, there are many other risks.

These include cost overruns, schedule delays, construction conditions, and regulatory and State fiscal uncertainties. It is also important to note that project investment will occur many years before gas flows down the pipeline and is sold at the marketplace.

With size comes complexity, and an even greater premium on getting the design concept, contracting and marketing plans right…and then executing these plans efficiently and effectively. Most importantly, size also amplifies the consequences of poor execution. Maximizing the value to the State of Alaska and the resource holders means selecting the right design concept for this mega-project and then executing to deliver the project at the lowest possible cost.

A limited number of companies have demonstrated the capabilities and financial strength to effectively participate in and manage world-scale mega-projects. The Producers are strongly represented as project developers in mega-projects worldwide, and have demonstrated success in meeting project objectives.

It is important to recognize that the federal government has helped address risks by enacting ANGPA of 2004 to provide regulatory certainty, completing FERC open season regulations, and establishing a Federal Coordinator position, which is held by Drue Pearce.

There are several reasons why a Producer Gas Pipeline Project is the best way forward. First, we believe a Producer gas pipeline project will result in maximum value to the State and the Producers. The Producers and the State have maximum incentive to control cost. Low capital and operating costs, which results in a lower toll, and access to premium market price results in higher netback value on gas. Keep in mind that the State will receive the majority of its revenue from value of gas sales, not from taxes.

There is no such incentive for third-party owners, who benefit from increased capital costs.

On a “mega-project” of this size and magnitude, project and operating experience should be a significant consideration. The Producers have the necessary project and operating experience in Alaska and world-wide. Specifically, we have “mega-project” experience on numerous projects world-wide and Arctic experience in Alaska and throughout the world.

In addition, it is important to remember that this is a basin-opening project, and any basin-opening project requires alignment between the host government and the leaseholders. The Producers and the State both want to develop ANS gas and open the basin to gas exploration.

Also, based on the demand for workers that this project will generate, Alaskans are obviously key to successful project execution. Both the State and the producers want Alaskans to benefit from the many job opportunities that will exist. When you add it up, a producer pipeline will provide maximum value to the State of Alaska.

Now I would like to briefly discuss how gas pipelines are financed and who ultimately bears project risks.

Commercially-sound oil, gas, and pipeline projects traditionally have been financeable if they have strong sponsors with proven track records and the financial strength to both provide sponsor equity and to backstop key project commitments. These commitments include any required completion support and firm transportation agreements, or FT. While the contractual commitments associated with this project will be substantial, the Producers possess the necessary financial strength to underpin such commitments.

To provide financing / funding to a pipeline project, financial institutions would generally require substantial firm, long-term, ship-or-pay contracts provided by creditworthy "shippers" that own and ship the gas (i.e., the Producers and, directly or indirectly, the State). These contractual commitments are substantial, in the tens of billions of dollars. FT commitments are needed for a pipeline investor to show creditors it has capacity confirmed over a

sufficient duration to secure financing. Therefore pipeline investors rely on the financial strength of shippers to secure project financing.

Through project financing, shippers provide the underpinning for the pipeline debt financing. The development costs and the associated over-run risk are ultimately borne by the shipper via the tariff commitment. Again, we believe only the Producers have the financial strength/incentive to backstop such commitments and bear such risk. Therefore, the Producers cannot make firm commitments unless they are confident the gas pipeline project can be built cost effectively and operated on a long-term, commercially viable basis, including being competitive with other sources of supply.

Because of the nature and magnitude of the risks – billions of dollars of financial commitments, unprecedented cost and scope, potential for construction delays - the parties taking the risks need to be able to manage those risks.

In closing, I would like to reiterate that ExxonMobil is committed to moving the gas pipeline project forward. Our company possesses the financial strength and project experience required to make this project a success. We are ready to get to work on putting in place a framework that would make the risks I've mentioned manageable and allow the project to progress. Thank you for your attention and for the opportunity to talk with you today. I look forward to addressing your questions.

2:12:54 PM

MR. HAYMES, in response to questions, reiterated that one billion cubic feet (BCF) per day would be ExxonMobil's share of the gas being moved through the gas line and that this would be a 10 percent increase in the company's daily worldwide production. He clarified that these figures are simply ExxonMobil's share of gas and that they do not relate to the total volume of gas that the pipeline itself would be capable of moving. He also clarified that his comment regarding "recent efforts" was in relation to the previous administration and the Alaska Stranded Gas [Development] Act, [not current efforts under the new governor].

2:14:42 PM

MR. HAYMES, responding to additional questions, affirmed his statement that estimates for building the gas line are now much higher than the 2001 estimate of $20 billion, and that these estimates are for building the gas line all the way to Chicago. He related that the costs of two other worldwide mega-projects increased by 50 and 100 percent in the last three years. He also noted that the Upstream [Capital] Costs Index (UCCI), a measure of labor and materials such as steel, went up 53 percent between the years 2005 and 2006. He acknowledged that he does not know what the current total estimate is for building the gas line because estimates are still being updated, but that the examples give an idea of the magnitude of recent cost increases. Mr. Haymes further reported that he has seen estimates for the gas line in the range of $30+ billion, but that those estimates are not ExxonMobil estimates. He remarked that there has clearly been a "super heated" cost escalation over the past few years.

2:18:30 PM

REPRESENTATIVE GUTTENBERG asked whether ExxonMobil is prepared to allow the state access to its royalty-in-kind gas on the North Slope and to allow transportation of the royalty gas through a producer-owned pipeline, given ExxonMobil's litigation against the state over Point Thomson.

MR. HAYMES said he did not have an answer and will get back to the committee.

2:20:36 PM

MR. HAYMES concluded his presentation by stating that ExxonMobil has been in Alaska for over 50 years and has invested over $11 billion in the state. He said ExxonMobil will be in Alaska for another 50-100 years and looks forward to working with the state to advance gas development.

2:21:15 PM

CO-CHAIR GATTO asked whether the First Nations of Canada have approved the gas line's planned route over their lands.

MR. HAYMES said he did not know.

2:22:51 PM

CO-CHAIR GATTO asked whether ExxonMobil would still be interested in moving its Point Thomson gas through an intrastate-only pipeline should a route through Alberta not come to fruition.

Mr. Haymes said that ExxonMobil would like to work together with the state on a gas pipeline and to progress Point Thomson.

2:24:21 PM

CO-CHAIR JOHNSON inquired as to whether ExxonMobil would allow gas line ownership by other companies that are willing to make firm transportation commitments (FTs).

2:24:38 PM

MR. HAYMES said he did not know the answer because he has only been in his new position for three and one-half weeks. However, he said that ExxonMobil is willing to work with the state to come up with a solution for commercializing the gas.

2:25:39 PM

DAVID VAN TUYL, Gas Commercialization Manager, BP Exploration (Alaska) Inc. (BP), stated that BP is keenly interested in the gas line project because it represents the largest known, but undeveloped, resource in the company's portfolio. He said that the gas line project plays a key role in extending the economic life of oil production on the North Slope. Therefore, BP stands ready to work with the new administration and the legislature to reach a balanced fiscal framework that works for all parties so that the project can successfully move ahead. This framework will set the foundation for a stable, healthy, and viable oil and gas business in Alaska for decades.

MR. VAN TUYL pointed out BP's long history of energy exploration and production on the North Slope, and that the company envisions being in Alaska for another 50 years. He discussed BP's share of possible energy production in Alaska through the year 2050, as illustrated on slide 2 of his PowerPoint presentation. He emphasized that the days of high plateau production are gone and that while today's production is still significant, it will continue to decline. He noted that BP will need to invest up to $1 billion annually to maintain production even though the production is declining. New investment in gas

and heavy oil resources is one way to make up for the decline, but only if there is a gas pipeline. A gas line will extend economic oil production from the North Slope and will allow heavy oil resources to be unlocked. It will create new gas exploration and development industry in Alaska and will generate a new source of revenue for both Alaska and BP. He emphasized that BP's future in Alaska is directly linked to this gas pipeline project, but that this opportunity also has world-scale challenges.

2:31:24 PM

MR. VAN TUYL, in response to several questions, stated that the projected net production depicted on slide 2 includes both new and current reserves. The gas pipeline is seen as an "enabler" because it extends the base life of facilities, thereby providing time for development of the technology necessary for accessing heavy oil. Additionally, it is possible that CO_2, a byproduct of the gas pipeline, might also be able to be used. He further explained that the difference between viscous and heavy oil is the degree of viscosity, and that heavy oil is the thicker of the two.

MR. VAN TUYL, in response to more questions, said he did not know what the [daily] flow through the Trans-Alaska Pipeline System (TAPS) was in 2003, but that he thought it was in the range of a million barrels or slightly above. He said that the gross daily flow today is about 800,000 barrels. He projected that if the $1 billion annual investment is maintained, the percent decline in flow will be about 6 percent per year; if the rate of investment is increased or decreased, the rate of decline will be more or less accordingly.

2:34:52 PM

CO-CHAIR JOHNSON asked at what volume does transporting oil through TAPS become uneconomical and when is this projected to occur.

MR. VAN TUYL said that he did not know, but that he will research the information and provide it to the committee. He confirmed Representative Gatto's statement that investment in new pump station equipment has now provided the ability to pump a smaller volume of oil through the pipeline than was previously possible, and that this will extend the life of the pipeline. He noted that investment in renewal of existing North Slope

facilities is also necessary in order to maintain the economic life of the oil fields.

2:36:17 PM

CO-CHAIR JOHNSON asked how long before the gas flows once there is an agreement with somebody for [building] the gas pipeline.

MR. VAN TUYL advised that once the "ink is dry" on an agreement, it will take about 10 years provided that everything works according to plan. However, he said that the answer could be different depending on who the "somebody" is.

2:37:34 PM

CO-CHAIR JOHNSON expressed his concern that there will be a time gap of several years between the end of life for TAPS and the first flow of gas through a gas pipeline.

MR. VAN TUYL, in response to comments by Co-Chair Johnson and further comments by Co-Chair Gatto, related that the Department of Revenue (DOR) is predicting the end of economic oil field life in the year 2030. He said he was unsure how BP's forecasts comported with the state's, but that he would provide that information to the committee.

2:39:52 PM

MR. VAN TUYL returned to his presentation and reiterated that the gas pipeline is a huge opportunity that also has significant risks, as summarized on slide 3 of his presentation. Project risks include the price, the costs, and fiscal and regulatory issues. Price is a significant risk because the resource owners are price takers, not price makers, and this is coupled with price volatility. Costs for materials, fabrication, labor, engineering, permitting, and equipment are significant risks because they have been rising dramatically in recent years, and that the cost risk is especially amplified on a mega-project. He defined a "mega-project" as any project costing over $1 billion. He said that the Alaska gas pipeline would be the largest privately funded infrastructure project ever. Another significant risk is the fiscal risk and this risk is mitigated by the investor knowing the rules. He emphasized that managing costs is absolutely critical to maximizing the value of the resource and that [the entities] holding the cost risk must be able to minimize and manage the costs.

MR. VAN TUYL noted that the project's risks ultimately reside with the resource owners - the state and the lease holders. He reviewed details of the various risks depicted on Slide 4. He noted that price and production risks are inherit with the resource itself, and that fiscal risks to the lessee are upstream changes in government fiscal terms, an example being the Petroleum Profits Tax (PPT). Changes in the regulatory process could result in a schedule risk for building the pipeline. There is a repayment risk to the capital markets that provide financing for the project. He explained that the schedule and capital market risks, along with the cost risks, are borne by the pipeline company. The pipeline company is a federally regulated entity that earns a regulated rate of return on its equity. The pipeline company is limited in the amount of risk that it is allowed to take, so the risk is passed on to the resource owners via the pipeline toll. Thus, all the aforementioned risks are ultimately borne either directly or indirectly by the resource owners that obtain capacity on the gas pipeline. Mr. van Tuyl explained the difference between the terms "toll" and a "tariff." A "toll" is the unit rate for cost of service on the pipeline. A "tariff" includes the toll plus the associated written terms and conditions for the pipeline service.

2:47:13 PM

MR. VAN TUYL emphasized that those entities bearing a risk are commercially motivated to manage that risk downward. He said that the producers are best positioned to manage the key project risks by having their affiliates own the pipeline. He directed attention to slide 5 and discussed why BP believes that the three producers are the best qualified and most motivated to deliver a successful project. He defined "successful project" as being a low cost, timely project that maximizes the value of Alaska's gas resource.

MR. VAN TUYL said that BP, ConocoPhillips, and ExxonMobil are qualified because they have a proven track record in: successfully delivering mega-projects, developing technology, pioneering Arctic energy development, and having the financial capability to make the multi-billion dollar firm transportation (FT) commitments necessary for this project. As an example of mega-project experience, Mr. van Tuyl noted that in 2006 BP successfully delivered the largest, most complex midstream project in the world - the Baku-Tbilisi-Ceyhan Pipeline Company ("BTC Co") project.

MR. VAN TUYL conveyed that the three producers are commercially motivated to deliver a low capital-cost project and a low operating-cost project. A low-cost project results in a low toll and maximum gas netback, thus maximizing the value of the gas to the producers and the state. He reiterated that BP is strongly motivated to deliver a successful project because the gas line is the key to BP's 50-year vision for its future on the North Slope.

MR. VAN TUYL contended that a third-party pipeline operator is not commercially motivated to keep the costs low because the operator's only source of income is the pipeline tariff. Cost increases will raise the rate base that the pipeline operator is allowed to charge, subsequently reducing the netback and resource value for the state and producers. A producer's commercial motivation is to develop the resources, not leave them undeveloped. Therefore, BP wants to advance the project promptly, but with discipline to ensure that the costs are managed. He advised that access to either a producer-owned pipeline or a third-party-owned pipeline is exactly the same because access is governed by the Federal Energy Regulatory Commission (FERC) in the U.S. and the National Energy Board (NEB) in Canada.

MR. VAN TUYL opined that the key is getting the risk and reward balance right. An open process, with the same rules for all parties, will allow the free market to work and move the project forward. The talk will end and the work will begin once the risk and reward balance is jointly defined. He declared that BP stands ready, willing, and able to work in that open process so the project can begin.

2:56:49 PM

MR. VAN TUYL, in response to Representative Roses, reiterated that BP feels it is the most qualified for the gas line project because of its international experience, technical expertise, and commercial motivation. He said that BP's commercial motivation is key because it owns the resource and wants to deliver that resource to the market at the lowest possible cost.

2:57:38 PM

CO-CHAIR GATTO questioned whether BP is really a price "taker" rather than a price "maker," given that it is both an owner and a major marketer of natural gas.

MR. VAN TUYL said that BP's production is only five to six percent of the market and that the company is considered a "merchant marketer" because it markets other companies' gas. He said that the market itself is highly regulated and that BP must "take the price that the market makes available to us."

MR. VAN TUYL, in response to questions from Co-Chair Gatto about the BTC Co project, confirmed that the oil-related segment of the BTC Co project is complete and that the gas-related segment is nearing completion. He explained that the midstream portion of the BTC Co project is analogous to the Alaska gas pipeline project and that it is built on "the back of a fiscal stability agreement" with the governments of Azerbaijan, Turkey, and Georgia, and that this agreement provided the terms for a 60-year, fiscal-stability contract. The 60-year lock on fiscal terms is the "government-take" and would be equivalent to the taxes and royalties associated with the Alaska gas pipeline. In further response to Co-Chair Gatto, Mr. van Tuyl said that BP has entered into long-term lease agreements with the state to have access to the resource for the purpose of selling it. Commercially, whether in effect or in legality, BP gets the economic benefit from that lease or "ownership." He noted his agreement with Co-Chair Gatto that a lease is treated the same way as ownership.

3:02:32 PM

CO-CHAIR JOHNSON asked what kind of financial resources a company would need to have to undertake the gas pipeline project if that company did not have FTs to finance the project.

MR. VAN TUYL advised that the $20-$30 billion of investment that will be required for building the pipeline is greater than the market capitalization of most companies, including General Motors Corporation. There must be confidence that the pipeline is being undertaken by a company that has the ability to backstop the investment required to deliver a successful project. He agreed with Co-Chair Johnson that not many companies would have this ability.

3:04:15 PM

REPRESENTATIVE GUTTENBERG expressed his concern regarding a recent FERC ruling that is being disputed by the producers. In his opinion, this dispute challenges the best interests of the state.

MR. VAN TUYL offered his belief that the challenge being referenced is FERC Order 2005-A. He explained that this dispute is over the narrow issue of whether or not the FERC can mandate design changes after an open season, and that this dispute has nothing to do with the open access rules. He said that BP supports open access because exploration volumes are needed to keep the pipeline toll low and provide benefit to all entities. In response to further questions, Mr. van Tuyl related that access to TAPS is granted under the Natural Gas Act of 2004 - any entity can obtain capacity to the pipeline any time there is an open season. He stated that he did not know if arguments had yet been made before the FERC regarding Order 2005-A and that he will get further information to the committee.

3:07:11 PM

CO-CHAIR GATTO turned the gavel over to Co-Chair Johnson.

3:07:45 PM

CO-CHAIR JOHNSON inquired as to whether only lease owners can enter into FTs; in other words, could a third party that does not hold leases make an FT.

MR. VAN TUYL related that any party can come to an open season and receive capacity on an open access pipeline as long as the party makes the commitment for a certain volume of gas for a certain period of time. He said that in the U.S., any natural gas pipeline that moves gas inter-state is an open access pipeline. He further explained that obtaining pipeline capacity is a corporate or individual commitment and that an entity that does not own gas today, but is expecting to own gas in the future, could go to an open season. However, he cautioned that shipper pay commitments obligate an entity to pay for moving gas whether or not it actually does so.

3:09:44 PM

CO-CHAIR JOHNSON asked whether BP would still participate in an open season if it is not chosen to construct the gas pipeline.

MR. VAN TUYL stressed that the project must be low cost to ensure that the tariff will be low enough for BP to get its gas to market for a reasonable rate. He said that BP, as a resource owner, would also need some form of guarantee that the risks it bears have been managed, particularly the fiscal risk on the upstream business.

3:11:36 PM

WENDY KING, Director of External Strategies, ConocoPhillips Alaska, Inc. (ConocoPhillips), assured the committee that ConocoPhillips is committed to advancing the gas pipeline project. While her supervisor, Joe Marushack, has moved to the company's Australian operations, an experienced and capable team is continuing to work on the pipeline. She advised that timing on this project is a real issue because competition is growing and the gas market is volatile. A volatile market tends to correct itself and the demand will look to additional or new sources to feed itself, such as coal and LNG. Another issue is competition for the actual critical components needed for the project, such as steel, machinery, and labor. She said there is common agreement that a project of this magnitude and complexity will take a timeframe of 9-10 years. She emphasized that it is important for the market to see Alaska gas coming forward soon. Due to this sense of urgency, ConocoPhillips will be doing what it can to find creative solutions to move this project forward.

MS. KING said ConocoPhillips believes that if the resource issues are addressed and firm shipping commitments are made, the pipeline project will happen. She defined "resource issues" as being the upstream portions of the project. She explained the concept of "netback" - if the market price is $6 and it costs $5 to get the gas to market, then the netback is $1. That $1 will have to cover the costs of finding, exploring, developing, and paying the taxes and royalties on that gas. Thus delivering the highest netback is something that ConocoPhillips is keenly interested in.

3:16:29 PM

MS. KING noted that a long-term shipping commitment requires payment to the pipeline operator regardless of whether a company actually ships gas on the pipeline every day. She said that long-term shipping commitments will be made in an open season within 18-24 months of the project moving forward. These commitments are key to financing the project and enabling it to move ahead. If the shipping commitments are based on an estimated toll of $3 and then the actual cost of building the pipeline is higher, the toll will increase proportionately. This means that the resource owners holding the shipping commitments will be "on the hook" for cost overruns, and that is why [the three producers] are uniquely motivated to keep those costs down.

MS. KING emphasized that the two components of the gas line - the resource and the pipeline - have very different risk-reward balances. The pipeline owner, unlike the resource owners, has stability and low risk because the return is regulated - if costs or taxes go up, regulations allow the pipeline owner to pass on those increases by raising the toll. She noted that the only time a pipeline owner has risk is prior to the open season. She said that ConocoPhillips estimates that the upfront costs prior to the open season will be about $400 million gross. This estimate is based on four seasons of gathering environmental field data for the preparation of environmental impact statements for FERC and NEB. In response to a question, Ms. King said that she did not know whether this estimate for upfront costs would be the same for other companies, but that it is consistent with the expenses being incurred on other large pipeline projects.

3:20:42 PM

CO-CHAIR JOHNSON asked what would happen if no FTs were made during the gas pipeline's open season. Would that be $400 million of upfront costs down the drain?

MS. KING stated that the initial $400 million is a very small risk in the scheme of this project. She explained that getting to the project sanction point will cost about $1 billion and take roughly four years: 18-24 months to get to open season, 6 months for the open season window, and about 2 years for the FERC and NEB permitting phases. During the period between open season and the project sanction point, there will be firm shipping commitments behind [the $1 billion in expenditures]. She further stated that the $400 million of exposure must also be looked at in comparison to the total cost of completing the project.

3:22:37 PM

CO-CHAIR JOHNSON commented that $400 million may not be much money to ConocoPhillips, but that it is a lot of money to the state and other people and that is why he is asking what kind of a balance sheet would be required for financing this project upfront.

3:23:34 PM

MS. KING, in response to questions from Representative Guttenberg, clarified that the figures and timelines she is quoting are for the Alaska North Slope to Alberta ("A to B") portion of the project, as well as additional commercial and engineering work to develop the appropriate solution from Alberta to the Lower 48 market. In response to further questions, Ms. King acknowledged that she is not an expert on the Canadian regulatory regime, but that ConocoPhillips currently has people in Canada working to lay the foundation for building the pipeline through Canada. She emphasized that ConocoPhillips believes there is a solution in Canada because the project will also bring benefits to that country.

MS. KING cautioned that discussion on pipeline "what-ifs" could become endless. She advised that at some point there must be focus on "the size of the prize." Moving the project forward will provide the opportunity for looking at other things such as spur lines, extracting different portions of natural gas liquids, other jobs, and new exploration and development prospects. Ms. King then warned against assumptions that this project is a "guaranteed economic return." All projects have risks and these risks are based on several issues: what is the price of the commodity, what is the cost of the project, will the reserves be there, and can the reserves be delivered at the rate. She said that predicting gas prices for the next 50 years is basically impossible. Regarding the project cost, she said that ConocoPhillips spent one million man-hours studying the last cost estimate. Since costs have escalated so significantly, ConocoPhillips cannot give a new estimate with confidence until more engineering, technical, and environmental work is completed. Ms. King related that U.S. Department of Energy (DOE) statistics show that exploration, development, and production costs have doubled since 1999. Additionally, the $20 billion project estimate does not include the costs of preparing the upstream fields. She also pointed out that a project of this magnitude will put a strain on resources throughout the entire world.

3:30:05 PM

MS. KING stated that ConocoPhillips will have to find more gas reserves if it signs a 20-year shipping commitment. This will require additional investment and there is no guarantee that those reserves will actually be there. Companies with firm shipping commitments will be on the hook for tens of billions of dollars, possibly even hundreds of billions, and this significant amount of investment requires getting the highest

netback possible. She said that ConocoPhillips wants an ownership position in the pipeline in order to align its project risk with its shipping commitment risk. During periods of low gas prices, ownership of the pipeline provides a hedge because the company is paying itself. She pointed out that this advantage would also have been there for the state had it taken an ownership in the pipeline. She emphasized that ConocoPhillips will be motivated to keep the costs down if it owns the pipeline.

MS. KING maintained that ConocoPhillips would bring management, technical, environmental, and regulatory expertise to the project. The company is experienced in Arctic and LNG operations, as well as world-wide mega-projects. She noted that ConocoPhillips owns 29,000 miles of pipeline through its downstream refining and marketing business, and the company has another 56,000 miles of pipeline in the U.S. through its midstream relationship with Duke Energy Field Services. She noted that ConocoPhillips is also a significant player in the chemicals business through Chevron Phillips Chemical Company LLC.

MS. KING pointed out that ConocoPhillips is Alaska's largest explorer and that it would like to bring in partners and co-venturers because it does not like to drill exploration wells at 100 percent working interest. Spreading out working risk among numerous exploration wells gives a "portfolio approach" and this is why ConocoPhillips wants new partners and entrants. She returned to the issue of netback and noted that the higher the netback, the greater the motivation to explore for more gas.

3:34:27 PM

MS. KING addressed the issue of FERC Order 2005-A. She said that if the design is changed after a company completes four years of environmental, engineering, and permitting work, it will take another two years to do the work again. ConocoPhillips is only challenging this narrow issue, she said.

MS. KING pointed out that ConocoPhillips is a large company with assets of $165 billion as of the end of 2006. The company has access to capital and to financial markets that will help with a project of this magnitude. As a 36 percent working interest owner in Prudhoe Bay and an owner in Point Thomson, ConocoPhillips also has access to the resource. Additionally, ConocoPhillips has a large position in exploration and other assets on the North Slope.

MS. KING stressed that ConocoPhillips is ready to solve issues. The resource issues must be addressed by providing adequate security to the companies that are being asked to make long-term shipping commitments. She said that Prudhoe Bay is unique to making this project happen because of its large natural gas volume. Since ConocoPhillips, ExxonMobil, and BP have working interest owner positions in Prudhoe Bay, they will be asked to make large shipping commitments. She reiterated that ConocoPhillips believes there is value in aligning an ownership position with a shipping commitment. Timing is important and ConocoPhillips wants to find new ways to come up with compromise for moving the project forward. The prize is tens of billions of dollars - if natural gas prices hold and if the costs can be managed. Additionally, the project will create a new exploration business for gas. Thus, ConocoPhillips is motivated to find solutions.

3:38:48 PM

CO-CHAIR JOHNSON requested that the three producers provide the committee with information regarding whether there will be a time gap between when moving oil through TAPS becomes uneconomical and when gas begins flowing through the gas pipeline.

3:39:49 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:40 p.m.