

ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE

April 14, 2007

10:02 a.m.

MEMBERS PRESENT

Senator Hollis French, Chair
Senator Charlie Huggins, Vice Chair
Senator Bill Wielechowski
Senator Gene Therriault

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Joe Thomas

COMMITTEE CALENDAR

SENATE BILL NO. 104

"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: SB 104

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

03/05/07	(S)	READ THE FIRST TIME - REFERRALS
03/05/07	(S)	RES, JUD, FIN
03/14/07	(S)	RES AT 3:30 PM BUTROVICH 205
03/14/07	(S)	Heard & Held
03/14/07	(S)	MINUTE(RES)
03/16/07	(S)	RES AT 3:30 PM BUTROVICH 205
03/16/07	(S)	Heard & Held
03/16/07	(S)	MINUTE(RES)
03/19/07	(S)	RES AT 3:30 PM BUTROVICH 205
03/19/07	(S)	Heard & Held
03/19/07	(S)	MINUTE(RES)

03/21/07 (S) RES AT 3:30 PM SENATE FINANCE 532
03/21/07 (S) Heard & Held
03/21/07 (S) MINUTE(RES)
03/21/07 (S) RES AT 5:30 PM SENATE FINANCE 532
03/21/07 (S) Heard & Held
03/21/07 (S) MINUTE(RES)
03/22/07 (S) RES AT 4:15 PM FAHRENKAMP 203
03/22/07 (S) Heard & Held
03/22/07 (S) MINUTE(RES)
03/23/07 (S) RES AT 1:30 PM BUTROVICH 205
03/23/07 (S) Heard & Held
03/23/07 (S) MINUTE(RES)
03/24/07 (S) RES AT 1:00 PM SENATE FINANCE 532
03/24/07 (S) Heard & Held
03/24/07 (S) MINUTE(RES)
03/24/07 (S) RES AT 3:00 PM SENATE FINANCE 532
03/24/07 (S) Heard & Held
03/24/07 (S) MINUTE(RES)
03/26/07 (S) RES AT 3:30 PM BUTROVICH 205
03/26/07 (S) Heard & Held
03/26/07 (S) MINUTE(RES)
03/27/07 (S) RES AT 3:00 PM BUTROVICH 205
03/27/07 (S) Heard & Held
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03/28/07 (S) RES AT 3:30 PM BUTROVICH 205
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03/29/07 (S) RES AT 5:00 PM BUTROVICH 205
03/29/07 (S) Heard & Held
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03/30/07 (S) RES AT 1:30 PM BUTROVICH 205
03/30/07 (S) Heard & Held
03/30/07 (S) MINUTE(RES)
03/31/07 (S) RES AT 12:00 AM BUTROVICH 205
03/31/07 (S) Heard & Held
03/31/07 (S) MINUTE(RES)
04/01/07 (S) RES AT 11:00 AM BUTROVICH 205
04/01/07 (S) Moved CSSB 104(RES) Out of Committee
04/01/07 (S) MINUTE(RES)
04/02/07 (S) RES RPT CS 6AM SAME TITLE
04/02/07 (S) AM: HUGGINS, GREEN, STEVENS, STEDMAN,
WIELECHOWSKI, WAGONER
04/02/07 (S) RES AT 3:30 PM BUTROVICH 205
04/02/07 (S) Moved Out of Committee 4/1/07
04/02/07 (S) MINUTE(RES)
04/04/07 (S) JUD AT 2:45 PM BELTZ 211
04/04/07 (S) Heard & Held

04/04/07 (S) MINUTE(JUD)
 04/11/07 (S) JUD AT 1:30 PM BUTROVICH 205
 04/11/07 (S) Heard & Held
 04/11/07 (S) MINUTE(JUD)
 04/11/07 (S) JUD AT 5:30 PM BUTROVICH 205
 04/11/07 (S) Heard & Held
 04/11/07 (S) MINUTE(JUD)
 04/12/07 (S) JUD AT 3:30 PM BUTROVICH 205
 04/12/07 (S) Public Testimony 5:30 pm to 7:00 pm
 04/13/07 (S) JUD AT 1:30 PM BUTROVICH 205
 04/13/07 (S) Heard & Held
 04/13/07 (S) MINUTE(JUD)
 04/13/07 (S) JUD AT 5:30 PM BUTROVICH 205
 04/13/07 (S) -- Invited Testimony --
 04/14/07 (S) JUD AT 10:00 AM BUTROVICH 205

WITNESS REGISTER

David Van Tuyl, Commercial Manager
 Alaska Gas Group
 BP Alaska
 Anchorage AK
POSITION STATEMENT: Offered perspective on AGIA

Mark Hanley, Public Affairs Manager in Alaska
 Anadarko Petroleum
 Anchorage AK
POSITION STATEMENT: Offered perspective on AGIA

Bill Walker, General Counsel and Project Manager
 Alaska Gasline Port Authority
 Fairbanks AK 99701
POSITION STATEMENT: Offered perspective on AGIA

Paul Fuhs, Legislative Director
 Alaska Gasline Port Authority
 Fairbanks AK 99701
POSITION STATEMENT: Offered perspective on AGIA

S.A. (BILL) McMAHON JR., Commercial Manager
 Alaska Gas Development
 ExxonMobil Production Company
 Houston TX
POSITION STATEMENT: Offered perspective on AGIA

Wendy King, Manager
 ANS Gas Development

ConocoPhillips Alaska, Inc.
Anchorage AK 99510

POSITION STATEMENT: Offered perspective on AGIA

ACTION NARRATIVE

CHAIR HOLLIS FRENCH called the Senate Judiciary Standing Committee meeting to order at [10:02:07 AM](#). Present at the call to order were Senators Wielechowski, Huggins, and Chair French. Senator Therriault joined the meeting soon thereafter.

SB 104-NATURAL GAS PIPELINE PROJECT

[10:02:23 AM](#)

CHAIR FRENCH announced the consideration of SB 104.

[10:02:27 AM](#)

DAVID VAN TUYL, Gas Commercialization Manager, BP Exploration (Alaska) Inc., delivered a PowerPoint presentation and paraphrased from written testimony

[10:03:19 AM](#)

MR. VAN TUYL referred to slide 2 - BP's Vision for Alaska - and outlined BP's long history exploring for, producing, and developing North Slope energy in Alaska and highlighted the opportunities for a bright future if the resource is appropriately developed. The graph characterizes BP's share of production through time including the current six percent annual decline. New investment resulting in new production is shown for viscous oil, heavy oil, and gas, but that's not a given; it's what is possible with a successful Alaska gas pipeline project, he said.

[10:05:21 AM](#)

MR. VAN TUYL referred to slide 3 - BP Key Messages - and emphasized that BP wants and needs a successful gas pipeline project that is built with low capital cost and operated cost efficiently. Low costs result in lower tariffs and higher netbacks meaning more revenue for the state and for BP. Also, a low-cost project will provide exploration incentive, which will keep the pipeline full into the future. "This is a hugely important project to BP, to Alaska and to the nation. It represents the largest, known, undeveloped gas resource in the United States, and in BP's global portfolio." Although gas is important in its own right, it will also extend the economic life of Alaska's oil production for decades. BP stands ready to

work with the administration and the legislature for a balanced fiscal framework that works for all the parties.

BP views AGIA as the administration's good faith expression to advance the gas pipeline project in an open transparent way, which is to be applauded. However, developing the right process is difficult and BP has identified a number of areas of concern. "We believe AGIA can be successful if some key issues are addressed."

[10:08:49 AM](#)

MR. VAN TUYL referred to slide 4 - What A Successful Gasline Means - and highlighted the tremendous scope and scale and risks and benefits associated with the project. Some of the benefits include jobs for Alaskans, additional revenue for future generations, increased economic activity, new businesses, a long-term gas supply opportunity for Alaskans, and a more diversified economy for decades to come.

[10:10:40 AM](#)

MR. VAN TUYL referred to slides 5, 6, and 7 all of which state that AGIA can help to deliver a successful gas pipeline if certain modifications are made. The first suggested modification is for AGIA to use objectives rather than prescriptive requirements. BP feels that some of the prescriptions contained in Section 140 starting on page 4 will not result in the best project. The administration's intent to let industry do what it does best is only met if industry is allowed to offer its own unique solutions.

MR. VAN TUYL highlighted toll subsidization as a particularly troubling example of prescribing a solution. Referring to Section 140(7) on pages 7 and 8, he said that language requires the initial shippers to bear the additional risk of tariff increases of 15 percent or more by subsidizing expansion shippers.

[10:12:20 AM](#) Senator Therriault joined the committee.

MR. VAN TUYL emphasized that BP believes that subsidization is contrary to FERC policy. Furthermore, the state should consider the potential adverse consequences of requiring pipeline owners to increase rates on their initial customers to subsidize expansion shippers. Doing so could put the project at risk. The state could make the policy choice to subsidize others, but it simply isn't good policy to do so with other peoples' money.

10:14:30 AM

SENATOR WIELECHOWSKI asked if he agrees that rolled-in rates encourage exploration.

MR. VAN TUYL clarified that the concern he's speaking about isn't with rolled-in rates it's with subsidization.

SENATOR THERRIAULT suggested that the real issue is what the FERC will consider to be a subsidy because there's a question about what that really means. If the tariff begins at one dollar and drops to 85 cents as a result of cheap expansions, would you consider it to be a subsidy if a subsequent expansion raised the tariff to 95 cents? It's still below a dollar, he said.

MR. VAN TUYL pointed out that there's no guarantee that the initial expansion will be cheap because it depends on things like the hydraulics of the system, fuel use, the extent of the expansion, and the volumes. He said he believes that's why the FERC language in the preamble to Order 2005 says that the issue needs examination on a case-by-case basis. According to his reading, the only definitive advice that FERC offers is that if the expansion results in the initial rate going down, then it's not a subsidy. Beyond that, FERC would have to look at the facts and make a determination. As the regulator of interstate gas pipelines, that's what FERC does, he said.

SENATOR THERRIAULT said that in the past FERC commissioners have indicated that going out to 105 percent was not considered to be a subsidy. Clearly, under that old rule you could see an increase beyond what you signed for initially and it still wouldn't be considered a subsidy, he stated.

MR. VAN TUYL said he too has that understanding and he imagines that's why FERC looks at it on a case-by-case basis.

SENATOR THERRIAULT observed that the language about the rebuttable presumption for rolled-in methodology is somewhat unusual. In his view that's because Congress directed that the line is to be constructed in a way that fosters competition and exploration. He asked if he believes that that's why the rebuttable presumption is there.

MR. VAN TUYL said it would be speculative for him to answer that. He understands that the language in ANGPA required setting rules to encourage exploration. He reiterated that BP has no problem with rolled-in rates. The issue is that AGIA could

result in a rate increase of significantly higher than 15 percent and that could raise the subsidy specter.

[10:19:31 AM](#)

SENATOR THERRIAULT noted that the producers continue to talk about a line running to Chicago, which would mean that about two-thirds of the line would run through Canada where rolled-in rates are the norm. He asked why it isn't a problem there.

MR. VAN TUYL said the regulatory body in the U.S. is the FERC and the regulatory body in Canada is the NEB and BP is happy to abide by the regulations that are provided.

SENATOR THERRIAULT asked why it's a problem to live with rolled-in rates on one-third of the line if it's not a problem on the two-thirds that runs through Canada.

MR. VAN TUYL again stated that BP does not take issue with FERC saying that for this project there will be a rebuttable presumption of rolled-in rates. The concern is that the FERC language highlights that the methodology should not result in a subsidy. "The issue we have is with the subsidization, not with the rolled-in rate."

SENATOR HUGGINS recommended that the state have an upfront conversation with FERC and ask for answers to the subsidy question. This is a provision that needs to be examined from the pipeline company's perspective, he stated.

CHAIR FRENCH stated agreement.

SENATOR WIELECHOWSKI asked what Canada's position is on subsidization and if it has a presumption of rolled-in rates.

MR. VAN TUYL said he would do some research and get back with a complete answer.

SENATOR WIELECHOWSKI commented that it doesn't make a lot of sense if two-thirds of the line has rolled-in rates and the rest of it doesn't. He also asked how it's possible to have an increase of greater than 15 percent.

MR. VAN TUYL explained that BP has four concerns with this portion of the bill. Three are technical and one is the overriding policy issue of subsidization. He explained the following:

The technical concerns result in the statement that we think that it could be more than 15 percent. The language of the bill relates to - this 15 percent is related to the initial, maximum, recourse rate to the downstream terminus. Those are three terms in the bill. Each one of those could result in that number being higher than 15 percent.

Initial because typically for rate-making purposes, a toll is levelized for a period and it depends on what's ultimately negotiated between the shipper and the customers. It could be 10 years, it could be longer, it could be shorter. But after that period of levelization, as the pipeline depreciates, the toll drops. And so if you're in the period where the toll is dropping, but you're still relating back to the initial rate, then the 15 percent is going to 16, to 20, to a larger number. That's one manner in which the magnitude could be more than 15 percent.

The second relates to the maximum recourse rate. And typically rates between customers and pipeline companies are negotiated rates. And those negotiated rates are typically less than the maximum recourse rate—10 or 15 percent, as much as 30 percent less in some cases. There's another if you're relating to the maximum recourse rate and you have a negotiated rate that's 15 percent under the maximum recourse rate, then you're actually talking about a gap there of 30 percent—not 15 percent.

The third issue relates to the downstream terminus. If the downstream terminus...is Chicago—don't know if we need to build new pipe to Chicago or a portion of new pipe and I don't know how the downstream terminus is defined. But if the expansion is only for a portion of the pipe, upstream let's say it's all the way from Alaska to Alberta. But the rate that you're measuring the increase against goes all the way to Chicago. That could add 50 cents, 75 cents to the amount that you're measuring 15 percent against.

MR. VAN TUYL said those three elements could result in an increase that's significantly higher than 15 percent.

[10:26:18 AM](#)

SENATOR THERRIAULT said the committee should consider modifying the language to address all or a portion of those concerns and he believes the administration is in agreement.

CHAIR FRENCH referenced Senator Therriault's previous tariff example and asked if BP would consider that to be a subsidy.

MR. VAN TUYL said he couldn't answer the question because he doesn't know what FERC would use to make the determination.

CHAIR FRENCH restated his question. "When BP...appears before FERC to have its say on that tariff adjustment, would BP be arguing that going from 85 cents to 95 cents is a subsidy or would it not?"

MR. VAN TUYL replied he would need more information because it would depend on a number of factors such as fuel usage. That's why FERC didn't give a definitive answer to that question, he said.

[10:28:24 AM](#)

CHAIR FRENCH said "Fair enough."

MR. VAN TUYL said the federal law made it clear that for mandatory expansions, FERC shall ensure that the rates do not require existing shippers to subsidize expansion shippers. In Order 2005, FERC put in place a rebuttable presumption of rolled-in rates for expansions provided it did not require subsidization by initial shippers. He read the following from Order 2005:

125. In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the Commission intends to harmonize both objectives (rate predictability for initial shippers and reduction of barriers to future exploration and production) in designing rates for future expansions of any Alaska natural gas transportation project. It is consistent with our guiding principle that competition favors all of the Commission's customers, as well as with the objectives of the Act, to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found.

MR. VAN TUYL said that a provision requiring a subsidy for not-yet-ready shippers at the expense of initial shippers would be a disincentive for potential shippers participating in an open season.

[10:30:47 AM](#)

MR. VAN TUYL referred to slide 6 and said a second recommendation for a successful gas pipeline is to avoid exclusivity. Sections 410 and 540 of AGIA would result in an exclusive winner before work is done and state funds would be awarded based on promises rather than results. This may preclude a successful project from moving forward, he said. BP understands that expedited regulatory handling is only offered to the licensed project and that the state could be penalized for assisting a competing project, but that approach could conflict with federal law and regulation, which favors competition and market involvement in the choice. Although the selection criteria under Section 180 is as transparent as possible, it leaves the fundamental question of whether the state should pick an exclusive winner based only on a proposal. BP is concerned with that approach. Instead it supports open competition in the marketplace. FERC requires that the market demonstrate the desire for an application before awarding a certificate to an applicant and that's what happens in a successful open season, he said.

MR. VAN TUYL said that the Alaska Natural Gas Pipeline Act (ANGPA) is a good model in which expedited regulatory handling is provided to any project. BP understands that from the state's perspective a number of specific things that are desired from any project. That includes things such as jobs, training for Alaskans, gas access for Alaskans, and pipeline expansions. BP supports all those objectives, he said.

[10:33:46 AM](#)

SENATOR WIELECHOWSKI asked if ANGPA is the federal model.

MR. VAN TUYL replied that's the federal legislation that passed in October 2004.

SENATOR WIELECHOWSKI asked if he sees any conflict between AGIA and ANGPA.

MR. VAN TUYL said the areas of conflict are complicated, but BP thinks that the ANGPA model provides expedited regulatory handling to any project. AGIA says expedited handling will be

provided only to the project that's selected. Those concepts are different, he said.

SENATOR WIELECHOWSKI asked if his understanding is that any group that is not selected as the winner could still get federal expedited regulatory assistance under ANGPA.

MR. VAN TUYL said he isn't sure how that would work.

[10:35:56 AM](#)

SENATOR WIELECHOWSKI asked if an unsuccessful applicant under AGIA could still go ahead with the project. The difference being that there would be no forthcoming benefits under AGIA.

MR. VAN TUYL said the concern is that BP isn't sure how the regulatory support that's required to advance any project would work for an entity other than the successful licensee. Also, there's potential for the state being penalized for providing certain kinds of assistance. It's different than the federal model that expedites any project so that a successful project emerges. That's the fundamental nexus of the concern, he said.

SENATOR WIELECHOWSKI pointed out that the state would still have the obligation to process materials from an unsuccessful licensee. The difference is that there wouldn't be an AGIA coordinator present to expedite the process.

MR. VAN TUYL said his understanding is that the benefits of the AGIA coordinator are exclusive to the licensee. BP's concern is what the breadth of the inducement that's offered under AGIA entails. If the state could be penalized for providing expedited regulatory handling to another project he questioned whether that other project could advance.

[10:37:49 AM](#)

SENATOR HUGGINS referenced the statement that AGIA may conflict with federal law and regulation and suggested the committee get an answer to that and put the issue to bed.

CHAIR FRENCH said he would forward the question to legislative legal.

[10:38:31 AM](#)

CHAIR FRENCH opined that the topic of exclusivity will be hotly contested, but from the perspective of many Alaskans BP, ConocoPhillips, and Exxon have had a sort of exclusivity for 30 years and a pipeline hasn't been built. Last year the process

wasn't successful and most Alaskans want ground work on the project to start next year. The only way that's going to happen is for the state to say it's about to pick a winner. If you're not ready then we'll get on a different pony and try to ride that one. If you are ready then bring us something this summer.

10:40:06 AM

MR. VAN TUYL said that once the resource terms are defined, the pipeline will follow. "To ensure that the pipeline gets built, that's going to be the single key enabler."

10:40:59 AM

MR. VAN TUYL continued the presentation and said that AGIA doesn't sufficiently address the resource framework for getting the project moving even though it is encouraging that it recognizes some important resource issues. He said that Section 310, page 16, seeks to address the royalty valuation issue, but the terms don't provide sufficient clarity to justify making the required firm transportation commitments. He explained that the royalty valuation provisions depend on future regulations and neither the shippers nor the legislature knows what they might say. Evaluation regulations would allow for retroactive adjustments and the regulations associated with royalty-in-value to royalty-in-kind switching imply that reasonable disproportionate costs and reasonable interference with marketing is okay. I don't know how to evaluate that when I run project economics, he said.

Section 310(a)(3), page 17, seeks to address royalty issues associated with RIV to RIK switching. This is incompatible with the long-term arrangements required to make a gas pipeline project happen, he stated. It is problematic because if the state chooses to switch from RIV to RIK the shipper would need to come up with additional gas to satisfy its customers in the marketplace. Another problem is associated with obtaining capacity on the pipeline if the state chooses to switch. For example, if the state originally elected to take gas in value, the shipper would have obtained capacity to be able to ship the state's share of the gas. If the state then switched to value in kind it could result in stranding downstream capacity that the shipper had obtained on behalf of the state to transport that gas. That raises the question as to who would pay for cost of that unused downstream capacity. AGIA leaves the solution to future regulation, which would allow the lessee to bear disproportionate costs and potentially interfere with long-term marketing.

Section 320, page 19, includes a provision related to gas production tax, but that tax rate will not be known until after the open season is concluded so a shipper wouldn't know what the production tax would be until after having made the firm transportation commitment. Also, the gas production rate is only established for ten years. That is a fraction of the period that shippers will probably be required to make their firm transportation commitments. Furthermore, AGIA silent on the many other payments made to the state, which constitute the majority of industry payments.

CHAIR FRENCH said in all fairness the gas production tax should be fixed sometime before the open season begins so an entity could make its last final calculation on what its bid should be for the gas. Referencing Mr. Scott's presentation about net present value of the flow of gas through the pipeline, he asked Mr. Van Tuyl his opinion on the basic point that the maximum risk to the company is during the first ten years. After that time the effect of a tax rate is fairly negligible on the net present value of the gas at the beginning of the term.

MR. VAN TUYL said he would address the concerns that that presentation raised in due course. "There are many things that I would take issue with and hope to discuss in more detail," he added.

CHAIR FRENCH asked if he would specifically address the question of net present value or if it would be addressed in a different format.

MR. VAN TUYL agreed to address the topic now. First, he said, when evaluating a project there are many different indicators, but the ability to generate long-term cash distinguishes gas projects around the world. That's why midstream mega gas pipeline projects are commonly built on the back of fiscal stability agreements. The project payout may be measured in decades so certainty over a long period is required and is consistent with the firm transportation commitments that are typically required to underpin these projects. For a project of this magnitude we would reasonably expect it to be up to 30 years out, he stated.

[10:48:06 AM](#)

SENATOR WIELECHOWSKI asked if he agrees that giving that kind of fiscal certainty would require change to the state constitution.

MR. VAN TUYL said he does not agree. BP believes it's constitutional for the state to enter a contractual arrangement to define the rules of take. "We believe that the arrangement that was proposed before was constitutional." We were confident enough in that assessment that we committed to spend \$125 million to continue advancing the project. If the issue were to be challenged it would be decided by the courts, he added.

CHAIR FRENCH said he doesn't know how the court will decide, but the real question is how to get a gas pipeline built regardless of how the decision comes down. If your company is wrong are you still willing to build a pipeline basing your tax stability on the fair and even-handed tax treatment you've gotten from this legislature for the last forty years?

MR. VAN TUYL said he believes BP is right, but if the court were to make a decision counter to that BP would need to make an evaluation at that time.

[10:51:03 AM](#)

SENATOR WIELECHOWSKI pointed out that BP is doing business in places such as Chad and Angola that are nowhere as stable as Alaska. How do you get fiscal certainty in a country where there could be a military coup at any moment, he asked.

MR. VAN TUYL explained that political risk relates to the jurisdiction in which a company does business while the fiscal risk is more a function of the project that a company is looking to invest in. Any project that requires a financial commitment that spans decades requires sufficient fiscal certainty to warrant the project.

SENATOR WIELECHOWSKI said it all comes down to politics. "I'm sure you had fiscal certainty in Venezuela when you went in there and now you have a 90 percent tax rate and you've had the oilfields nationalized." I don't see how you could get better fiscal certainty in those countries than in Alaska, he said.

MR. VAN TUYL said in evaluating the forward economics of the project it's necessary to know what the payments to government will be for decades. Once the investment is made it would be very rational for a government to take another look at what the government take should be. "That's a huge risk for an investor looking to make firm transportation commitments of tens of billions of dollars."

[10:53:51 AM](#)

MR. VAN TUYL said it's understood that the resource owners will bear the cost and risk of building the pipeline either directly or indirectly. It's the resource that drives the construction of the pipeline so solving the resource issues with clarity is key to advancing the project. "Just like Wall Street needs to know the rules before lending money, resource owners need to know the fiscal rules that will govern the project before making commitments that will enable the project to advance." The details of an upstream framework are complex and BP is concerned that the provisions of Sections 310 and 320 don't adequately address those upstream issues. Thus far there have been robust discussions between senior management and the governor and her staff, but the level of interaction with the commissioners and their staff has been a disappointment. Ultimately that's where the problem will be solved so additional discussion is welcome.

10:55:52 AM

MR. VAN TUYL said he's concluded that the nature of firm transportation commitments isn't fully understood. He explained that FTs are typically obligations that the resource owners or shippers make to ship or pay and they're needed by the pipeline company to get financing. "Validating just how important they are, we've heard some very simple and straightforward comments from pipeline companies who've testified in the past couple of weeks. TransCanada has said, 'No customers, no credit, no pipeline.' In this context customers means shippers. Enbridge put it even more simply by saying, 'No producers, no pipeline.'" Those statements are not political, they're about financial truths of gas pipeline projects. FTs are a binding financial obligation in which the shipper commits to pay the pipeline company for use of its service regardless of whether the shipper delivers gas to the pipeline. Another important point is that a company doesn't need any gas resource to enter into the commitment. Any company that meets the standards of credit worthiness that the pipeline company sets is free to bid for capacity. Gas pipelines are open access so anyone is free to obtain capacity if the required commitments are made.

MR. VAN TUYL continued to explain that because FT commitments are financial obligations, they must be disclosed in FCC filings. "Clearly a firm transportation commitment of this magnitude...will be taken into consideration by financial entities like banks when evaluating our company." Once the commitments are made, the pipeline company uses them to obtain financing from the financial markets, provide coverage for the financing and get a return for the pipeline.

MR. VAN TUYL posed an example where a successful open season was held and the pipeline was financed built and in operation. Then for some unforeseen reason the pipeline goes bankrupt. At that point the lenders would turn to the FT commitments made by the shippers to get repayment. The lenders would receive those FT payments because they are a real financial commitment. Mr. Van Tuyl explained that the reason BP takes exception to some of the numbers that were shown previously, and Senator Wielechowski pointed it out, is that for an independent pipeline the economics were shown to be high double-digit returns whereas with a producer ownership they were lower. That's because FTs weren't taken into consideration. To properly evaluate project economics they simply must be taken into account, he stated.

MR. VAN TUYL emphasized that the scale of the commitments is often over simplified. It's not just the capital cost of the project.

[10:59:42 AM](#)

SENATOR WIELECHOWSKI asked if he agrees that BP's leases require it to put gas into the pipeline if it's reasonably profitable.

MR. VAN TUYL replied he isn't familiar with specific language but he does know that BP has and will continue to abide by its lease requirements.

SENATOR WIELECHOWSKI said this is a critical question because if the lease agreement requires a company to put gas into the pipeline if it's reasonably profitable, then he doesn't see how a company could refuse.

MR. VAN TUYL replied he didn't believe the language of the lease actually contains that phrase, but he would verify that. "But clearly if we saw the opportunity for the project that was depicted here of high double-digit rates of return we would absolutely be pursuing that project." The project doesn't appear to be that robust and it appears to have tremendous risks, he said.

SENATOR WIELECHOWSKI asked if BP has developed spreadsheets that show rates of return and net present value.

MR. VAN TUYL replied they have made estimates of the project economics, but they haven't done a bottoms up cost estimate.

SENATOR WIELECHOWSKI asked if it's a profitable project.

MR. VAN TUYL replied it has the potential to be profitable if the resource terms are established such that the investment can take place. Right now it's too uncertain because the capital cost is unknown. We don't know if it's profitable now, he stated.

SENATOR WIELECHOWSKI expressed amazement.

MR. VAN TUYL said BP believes there's a reasonable prospect, but before that question can be answered with certainty BP would need to know the capital cost of the project, the resource terms, and the nature of the firm transportation commitments. Until those are defined the answer is "unknowable," he stated.

[11:03:31 AM](#)

SENATOR HUGGINS posed a scenario where a pipeline company conducted an unsuccessful open season, but because of the terms in AGIA it was compelled to continue on to pursue a FERC certificate. He asked how such a scenario would impact a producer like BP.

MR. VAN TUYL said a successful open season has three essential elements: 1) knowing the cost of project; 2) knowing the resource terms; 3) the nature of the FT. If those three elements are in place he'd be fairly confident that it would be a successful open season. He added that he doesn't understand why a company would commit to a project if doing so would expose it to massive loss. That's one scenario where the open season would fail, he said.

[11:07:05 AM](#)

CHAIR FRENCH posed a situation in which BP did not win the license, but was still interested in making a FT commitment. "Wouldn't you compare your internal estimate of what you think the cost is going to be to what the pipeline is saying it's going to be just so that you can make the best educated guess that you can when you nominate your gas?"

MR. VAN TUYL said absolutely. He added that it's common for the pipeline company to consult with its customers before an open season to ensure that its customers are interested in the service that the pipeline company envisions.

CHAIR FRENCH asked if he agrees that under AGIA an open season would take place within 24 months.

MR. VAN TUYL said his understanding, depending on the draft, is that it would be either 24 or 36 months.

SENATOR THERRIAULT said if a company proposes to be a major shipper it's not uncommon for it to enter into an agreement with the proposed builder to have significant oversight and perhaps outright control of the construction project even though it is not that company's construction project.

MR. VAN TUYL replied that any range of commercial agreements can be negotiated. What will be important is that the pipeline company deliver the project that's being negotiated. Perhaps that would be a term of negotiation, he added.

SENATOR THERRIAULT asked Mr. Van Tuyl if he had additional slides on the FT issue.

MR. VAN TUYL said no.

SENATOR THERRIAULT said he asked because he believes that this is a major point of disagreement. He said he appreciates that today he didn't use the term debt because even though the \$144 billion commitment to pay for transportation may be a drag on the corporate balance sheet, the fact is that you may be able to book a \$200 billion or \$300 billion asset.

[11:10:36 AM](#)

MR. VAN TUYL said that's not quite correct. He explained that BP would make the FT commitments at the open season and typically that event would not result in the reserves being moved from known resource to proven reserves. That usually takes place some years later after the project is actually sanctioned, he said.

SENATOR THERRIAULT asked if it's footnoted initially as a possible obligation and after certification it becomes a sure thing.

MR. VAN TUYL said it's a binding obligation in the period when the binding agreements are signed. The fact that the obligation has been entered into is reflected to the FCC.

SENATOR THERRIAULT asked when the value of the reserves is actually booked.

MR. VAN TUYL said booking of the reserves occurs at project sanction. That typically occurs once the FERC certificate is issued and the record of decision has been reviewed and

finalized. Once the company has committed its portion of the capital, the auditors make sure there is the requisite corporate authority to release funds to go forward with the project. Typically, at that point the auditors would allow a company to move the reserves from known to proven.

SENATOR THERRIAULT said but even after project certification you don't actually start making payment on the obligation until the first gas flows. You're able to book that value and maybe four years later you start making the payments. Even then you don't transfer \$144 billion in capital. It's just the transportation obligation for that first year.

MR. VAN TUYL said the obligation is in the total amount and for the entire term. Also, another obligation that has to be taken on and reflected is the completion guarantee. That would be a term of negotiation between the builder and the shippers, he said.

[11:13:24 AM](#)

MR. VAN TUYL continued the presentation and said the conclusion is that FT commitments do represent real risk to the resource owners.

MR. VAN TUYL said that slide 9 depicts that in a project like this, all the risk reside with the resource owners. Those include: price risk, fiscal risk, production risk, toll risk, fiscal/schedule risk, cost risk, and finance risk. BP believes that those that bear the risk are commercially motivated to manage it downwards and thus should be in a place to manage that risk, he said.

[11:14:49 AM](#)

MR. VAN TUYL said in summary BP wants and needs a successful gas pipeline. It supports an open and transparent process leading to a mutually agreed to framework that allows the project to advance. Furthermore, BP believes that an open and transparent review should involve the legislature supporting the framework that the governor has already committed to. The judicial branch should review the framework to ensure that it is constitutional and the people of Alaska should be consulted. The midstream details should be addressed such that they encourage the best solution by allowing industry to offer objectives rather than having them presupposed up front. The issue of subsidization should not be required. Actual marketplace performance should determine the winner rather than selecting a winner before performance is started. Finally, agreeing on the upstream

framework is critical because resource issues must be resolved for the project to proceed.

11:16:30 AM

SENATOR THERRIAULT referenced antitrust issues and asked if he agrees that if the producers were to propose purchasing an existing oil pipeline, the federal government would likely place stipulations on the purchase

MR. VAN TUYL said he doesn't know what the federal government might do.

Recess from 11:17:36 AM to 11:28:19 AM.

CHAIR FRENCH reconvened the meeting and asked Mr. Hanley to present Anadarko's perspective.

MARK HANLEY, Public Affairs Manager in Alaska, Anadarko Petroleum, relayed that as an explorer Anadarko is generally aligned with the producers, but it does have some differences.

MR. HANLEY showed a map reflecting Anadarko's investment on the North Slope and said that the partnership with ConocoPhillips has been beneficial. In response to a question he explained that the green areas depict operating fields. Anadarko continues to be keenly interested in access to a pipeline and has been consistent in its effort to get fair access at a reasonable rate, he stated.

MR. HANLEY answered a recurring question and explained that Anadarko will continue to drill so it can maintain current leases and so it is ready for either the initial open season or the first expansion. Because of the incentives Anadarko would prefer to be in the initial open season, but under the timelines it's unlikely, he added.

11:34:56 AM

MR. HANLEY stated general support for the AGIA process, which provides opportunity for input on the initial legislation, during the public comment on the submitted applications, and during the legislative review. Arguably it also provides a bit of competition. However a long-standing concern relates to letting the marketplace decide in when there really is no competition. Before the recent change at Pt. Thomson, three companies controlled over 90 percent of the gas. When the pipeline was debated in the 1970s a lot of concerns were voiced because of the likelihood that the producers would control the

resource and own the pipeline. Those things cause additional concern, he said. It shouldn't be prohibited, but extra scrutiny and extra stipulations are warranted. That's part of what AGIA provides, he said.

MR. HANLEY said the process lays out "must haves" that will be required of any applicant and as an explorer we like them and believe they ought to be in the bill.

[11:37:16 AM](#)

SENATOR WIELECHOWSKI asked if he agrees with BP that the exclusivity of AGIA raises concerns.

MR. HANLEY replied Anadarko has not been opposed to exclusivity.

[11:39:11 AM](#)

MR. HANLEY stated that Anadarko supports the mandatory provisions on access and rates. It's appropriate that the pipeline company is required to assess the market demand for expansion every two years. After that, it's critically important that the pipeline company is willing to commit to expand in reasonable increments on reasonable terms. Anadarko also supports rolled-in rates up to 15 percent above the initial rate and the agreement not to enter into negotiated rate agreements that would preclude those rolled-in rates. These provisions are reasonable, they fit together, and they are critical to ensure more exploration.

MR. HANLEY said Anadarko is motivated as an explorer without identified gas, but he might be arguing a different side if his company had a large gas reserve and didn't want to explore. He suggested it would be interesting to ask which hat the producers are wearing when they're testifying because they certainly have different motivations than pipeline companies. For example, when a pipeline company acts as a consolidator it might argue to FERC that it should get a 20 percent rate of return because the pipe is risky. The normal tension is set up because the shippers would argue that from their perspective they are really taking all the risk.

[11:42:07 AM](#)

CHAIR FRENCH asked where in the process that decision gets made.

MR. HANLEY said he doesn't know, but he could get the answer. He continued to explain that the tension that he described is normal, but the concern that Anadarko has relates to a company that wears both hats. If you have a producer owned pipe, they

absolutely want the lowest cost, but what is their incentive on the rate? He said he suspects that the overall incentive in an integrated company would be to have the lowest cost and the highest rate of return. You could sort of pay yourself and reduce the wellhead value, which means that severance taxes and royalties to the state would be less. Anadarko would be affected because it isn't a pipeline owner. Obviously we would get the lower severance taxes, but we would get that because we would be paying the higher rate. The difference is that we wouldn't be putting it into our own pocket, he said.

11:43:57 AM

SENATOR HUGGINS asked if he is saying he doesn't want a producer owned line

MR. HANLEY said his company has testified previously that it would be more comfortable with a third-party owned pipe, but it's all relative because the producers bring some benefits as well. Additional stipulations are justified, he said. "You saw some of that in the FERC regulations and I think that's why we support some of these provisions here."

SENATOR HUGGINS asked what he thinks about having a divestiture requirement if the producers become a majority holder of initial ownership.

MR. HANLEY said he'd need to think about that, but what's really important is to make sure that the appropriate terms and conditions are established from the beginning. Acknowledging that the companies have differences of opinions about what those are, he reiterated that that's why Anadarko supports the provisions in this particular bill.

SENATOR HUGGINS stated that he would be 100 percent against any concept that caused the producers to have some control factor that worked to Anadarko and the state's detriment for expansion and greater exploration.

SENATOR THERRIAULT asked if a lot of Anadarko's concern springs from oil production issues and the current TAPS tariff struggle with the producers.

MR. HANLEY said he isn't sure that's what it stems from, but the producers are looking out for their corporate interest. They're getting a rate of return and Anadarko is challenging it before FERC arguing that the rates are \$3 a barrel too high at today's rates on the TAPS. He noted that the RCA decision suggested

over-collections of \$10 billion up to about 1997. Obviously that's a matter of concern because the producers will push the envelope to the extent that they can. Returning to the original point about ownership, he said that if the producers didn't own the pipe, the pipe might be proposing some of these things to get those rates of return.

[11:47:35 AM](#)

MR. HANLEY referenced the statement that AGIA could result in one party subsidizing another and said AGIA doesn't require a subsidy; it requires the pipeline to request rolled-in rates up to a certain level. It's up to FERC to decide whether or not it's a subsidy. The distinction is that the producers may never propose a rolled-in rate if they own the pipe. Even in Senator Therriault's scenario, they might not ask for the increase to be rolled-in. "Would you want your rates to go up at all even if it's not a subsidy?" He emphasized that the key for Anadarko would be to ask for rolled-in rates. The shippers are free to argue against it, whether the companies are affiliated or not, and FERC will decide under its rules.

[11:49:57 AM](#)

SENATOR WIELECHOWSKI asked if he would object to tightening the language in the bill to address the suggestion that the increase could be more than 15 percent.

MR. HANLEY said he believes there are legitimate issues to support tightening the language, but he doesn't have any specific suggestions.

[11:51:08 AM](#)

SENATOR THERRIAULT asked if he agrees that the "must haves" in AGIA would force the pipe to operate somewhat like an independent pipe even if the major producers were the owners.

MR. HANLEY said yes, which is why it's appropriate to get the producers to ask for rolled-in rates.

[11:52:10 AM](#)

SENATOR HUGGINS said if FERC isn't bound by the language in the bill, then whatever is written will have minor impact.

MR. HANLEY said the tension is whether the pipe will ever ask for a rolled-in rate.

CHAIR FRENCH asked if the presumption for rolled-in rates would be overcome if the pipe were to ask FERC for an incremental rate.

MR. HANLEY said not necessarily because you wouldn't know what they might advocate for.

SENATOR HUGGINS added that the presumption is a special provision and he assumes it's more than a minor statement written on a piece of paper.

SENATOR THERRIAULT explained that it stems from the special language that Congress gave for developing this particular package of regulations. At that time the state, Anadarko, and the Department of Interior testified before FERC in favor of having rolled-in rates, but FERC was only willing to go as far as a presumption. The state's position was that it wanted rolled-in rates so it is a concern to suggest changing the language to say it's just a presumption and that the state won't require companies that want to nominate for capacity to support rolled-in rates. "I'm not sure why we would back off at this point from what we've been asking for for the last--probably--three years," he stated.

[11:54:59 AM](#)

SENATOR HUGGINS noted that the administration indicated it has the data to shed light on this. We need to see what the parameters are because it's an unanswered question, he said.

CHAIR FRENCH asked when the information would be forthcoming.

SENATOR HUGGINS said it's outstanding and he assumes it's being worked on. "The administration agreed--to leave the language in until the question was answered." He said that the administration isn't at odds with the resources committee or the Senate; it was an agreement.

[11:55:59 AM](#)

MR. HANLEY read paragraph 124 from Order 2005 to address the question of whether or not a \$1 tariff that went to 85 cents and then 95 cents would be a subsidy.

We cannot at this point, without a specific project proposal or the facts surrounding a proposed expansion before us, define exactly what will be required to overcome the presumption. As a general matter, we have historically not favored requiring existing shippers

to subsidize the rates of new shippers. We do not intend to discard this principle, but rather to indicate that we will not lightly authorize expansion rates that would have an unduly negative impact on the exploration and development of Alaska reserves. Witnesses at the technical conference acknowledged that defining subsidization is difficult without specific facts to review, and that fact was restated in several of the comments filed. We agree. But a basic observation may be useful here. For example, a rolled-in expansion rate that is less than or equal to the rate paid by the initial shippers would not be considered a subsidy. Whether a rolled-in expansion rate that is higher than original rates is a "subsidy" is a question that necessarily would have to be reviewed in the context of a future NGA section 7 filing. At that time, Pacific Star's arguments relating to whether the federal government's loan guarantees and accelerated depreciation amount to a "subsidy" of initial shippers' rates may be raised.

MR. HANLEY said it gets complicated because some are arguing that an initial shipper's rates are already subsidized through federal loan guarantees and accelerated depreciation. He opined that that shouldn't be considered.

CHAIR FRENCH said it seems relatively black and white that you can't get a subsidy when you're under the initial rate.

MR. HANLEY agreed and said he mentioned it because it does seem to directly answer that particular question.

SENATOR THERRIault highlighted a conversation he had with the administration about where the 15 percent figure came from. He learned that the administration looked at whether the faster depreciation and access to the federal loan guarantee is an actual subsidy that the initial shippers take. Perhaps that initial \$1 rate really would have been \$1.15 if there were no federal incentives. FERC will need to take those things into consideration in the future, he said.

MR. HANLEY said the provision that requires asking for rolled-in rates is important and the provision requiring expansion in reasonable increments is also valuable. He explained that the FERC process provides for two avenues for expansion—voluntary and mandatory. The voluntary process seems to be where everyone is relying on the presumption of rolled-in rates, but the

pipeline could say no and force the mandatory process. Obviously, we're not absolutely comfortable that we'll end up with a voluntary expansion and a presumption of rolled-in rates, he stated.

[12:01:44 PM](#)

MR. HANLEY showed a graph of expansion tariffs to demonstrate how 4.5 bcf/day might be expanded and what indicative rates might be. At 4.5 bcf/day the tariff is \$1.62. After the first compression expansion the capacity increases by 1 bcf/day and there's an incremental tariff of \$1.07 and a rolled-in tariff of \$1.47. Everybody's rates go down. That's the way FERC would do it in the Lower 48 and presumably it would be the same in Alaska, he said.

CHAIR FRENCH asked if the incremental approach would result in the new shippers paying the \$1.07 tariff since all they are adding is the compression.

MR. HANLEY said yes, but FERC's general policy in the Lower 48 is to roll in the rates when the expansion reduces the rates and go to an incremental policy it increases the existing rates.

CHAIR FRENCH asked if the net result of the expansion would be to bring everybody's rate to \$1.47.

MR. HANLEY said yes.

[12:03:50 PM](#)

SENATOR WIELECHOWSKI observed that the expanders are essentially subsidizing the initial producers' decreases.

MR. HANLEY acknowledged that there is debate about what constitutes a subsidy. He was simply explaining how FERC policy typically works.

SENATOR THERRIAULT said it seems that whether it's rolled-in or incremental, the way the system works is that it's rolled-in as the price goes down and everybody benefits.

MR. HANLEY said yes, and Anadarko believes it would work the same way under current FERC policy for Alaska.

Returning to the graph, he explained that it shows that the second compression expansion is more expensive. At 6.5 bcf/day the incremental tariff is \$1.73 and when it's rolled-in with the

\$1.47 tariff the combined rate rises to \$1.51, which is still lower than the initial rate.

After looping, the capacity is 7.5 bcf/day and the incremental tariff is an expensive \$3.25, but if the rates are rolled-in, the tariff is \$1.71. The example demonstrates the potential magnitude of a looping expansion and the tension that occurs in the system if the rates aren't rolled-in.

[12:06:41 PM](#)

CHAIR FRENCH stated for the record that he's always found the word "looping" to be misleading because the pipe is not being looped. Rather, new sections of pipe are built around bottlenecks.

MR. HANLEY described looping in terms of passing lanes on a highway.

CHAIR FRENCH asked if the folks that were already in the pipe would pay an incremental tariff of \$1.71 or \$1.51 after the looping expansion.

MR. HANLEY said they'd pay the \$1.51 tariff.

SENATOR HUGGINS asked for a timeline for seeing the \$1.47 tariff.

MR. HANLEY said the first assumption is that a pipeline is going forward, but it might be 2014.

SENATOR HUGGINS asked about a scenario where there's an unsuccessful open season. "You have the gas and the state tells the licensee to go to a FERC certificate." Would you commit your gas?

MR. HANLEY said if he has gas available at the open season and the terms were right he might have been there and committed his gas.

SENATOR HUGGINS mentioned the 5-year window and an unsuccessful open season and asked, "What would you see in that 5 year window assuming you came across some volume of gas--still having an unsuccessful season as a backdrop to the scenario."

MR. HANLEY said they'd make a judgment at the time because it's a decision-tree process.

SENATOR HUGGINS said, "Your reaction is much like some of the others and rightfully so."

SENATOR THERRIAULT said, but if you did find a sizeable reserve, you may be begging for another open season and your success may be what prompts opening the question again.

MR. HANLEY said it could be, but it's all theoretical.

SENATOR THERRIAULT referenced the chart and asked what guarantees two relatively cheap expansions after the initial pipe. He asked if it isn't true that the pipe could be sized initially at the step three compression so there wouldn't be a cheap expansion.

MR. HANLEY said his last slide addresses that question.

12:13:11 PM

SENATOR WIELECHOWSKI asked if it's fair to say that if incremental tariffs were allowed, we'd essentially cost ourselves out of an expansion between 6.5 bcf/day and 7.5 bcf/day.

MR. HANLEY said yes; under this scenario with incremental tariffs the expansion would not be economic.

SENATOR WIELECHOWSKI reviewed the chart and asked if it's fair to say that the state could potentially lose hundreds of millions if not billions of dollars if incremental tariffs are allowed.

MR. HANLEY said there is that potential, but it depends on where the gas comes from. The numbers, which came from the administration, are illustrative and highlight the concepts. He noted that TransCanada suggested that with 48 inch pipe, it could expand from 4.5 bcf/day to 7 bcf/day and as long as the rate is rolled-in, it would be lower than the initial rate. We'd be happy with that kind of scenario, he said, because there's lots of opportunity to compete for that expansion capacity. He said that leads into Senator Therriault's question about the possibility of building a pipe that's fully compressed from day one. It could probably be designed that way and it would likely be the lowest cost pipe that you'd have. However, the first expansion would start on the looping and that would be risky.

MR. HANLEY said his last point relates to the current federal court challenge of FERC authority. The producers want to

eliminate Sections 157.36 and 157.37 relating to open seasons for expansions and project design. We believe that the protections provided in those sections are appropriate. We're aligned with the state and FERC on maintaining those rules, he stated.

SENATOR HUGGINS said one of his major concerns is getting into the scenario where the pipe is under designed.

SENATOR THERRIAULT opined that Congress gave FERC the unusual authority to mandate design changes because of that final \$3.25 bar. Congress owns a lot of land up on the North Slope on behalf of the U.S. citizens and doesn't want to see its undiscovered resource priced out of the market. It's unlike the Lower 48 where you might have competing pipelines that can deliver from a basin; this might be the one and only pipeline. Congress knew that and gave that specific direction to FERC. FERC understood and came out with the particular package of rules, he stated.

[12:20:25 PM](#)

MR. HANLEY said that's why we think this package with its critical components fits nicely. In summary he said we like the AGIA process and the opportunity to submit concerns. We like the specifics, which makes us more comfortable in going forward with exploration.

SENATOR HUGGINS commented he found the testimony refreshing and balanced. He said thank you on behalf of my constituents; I appreciate your approach and believe Alaskans do too.

CHAIR FRENCH agreed and thanked Senator Huggins for saying so.

SENATOR THERRIAULT asked if he had any comment on the discussion regarding potential antitrust issues related to a producer owned pipeline.

MR. HANLEY said he doesn't have a comment.

SENATOR THERRIAULT asked if Anadarko would likely partner with another company to spread risk if it found something that looked promising in the Foothills acreage.

MR. HANLEY said Petro-Canada and BG are already partners in the Foothills. Generally, each partner has a one-third interest and Anadarko is the operator. It's a high risk frontier-type exploration play so you want to share the risk.

12:23:14 PM

SENATOR THERRIAULT asked if he has any idea why the producers wouldn't want to share the risk of building the pipeline just as they do for exploration and development.

MR. HANLEY said he didn't want to speak for the producers, but he imagines they consider the three-way partnership as sharing the risk. He's heard and would probably agree that the risk is in the construction so controlling the cost is critical.

SENATOR THERRIAULT asked about the issue of needing long-term fiscal stability on gas and oil.

MR. HANLEY said "We'd like as much long-term fiscal stability as we can get." The initial open season provides benefits that we believe should apply for expansions because the same risks apply, he added. That's a change we would suggest even though we understand the motivation to provide incentive to show up at the initial open season. From our perspective that creates a competitive advantage, he said.

SENATOR THERRIAULT said even though your company might not participate in the initial open season, you don't appear to be folding your tent and exiting the state so you must see a workable scenario going forward.

MR. HANLEY said the company has a decision-tree process and it's too early to speculate on what it might need. We'll go forward and do what's necessary to hold our leases and prove up some concepts. But, he reiterated, we're interested in fiscal stability for as long as we can get.

12:27:39 PM

SENATOR HUGGINS asked what exploration tax incentives Anadarko might benefit from.

MR. HANLEY said the PPT language slightly improved exploration economics.

SENATOR HUGGINS asked him to think about what the state might do to incent Anadarko and others to participate in future expansions.

MR. HANLEY suggested having a debate around tax rate levels and tax credits for gas.

SENATOR THERRIAULT highlighted a 30 page memo and two page introduction from Mr. Shepler at Greenburg Traurig, evaluating antitrust issues and what the producers might need to do to obtain Department of Justice clearance.

CHAIR FRENCH said that sounds helpful and he'd make sure that copies are distributed.

Recess from [12:33:16 PM](#) to [1:45:39 PM](#)

CHAIR FRENCH reconvened the meeting and announced the next item on the agenda is a presentation from the Alaska Gasline Port Authority.

BILL WALKER, General Counsel and Project Manager, Alaska Gasline Port Authority (AGPA) and Paul Fuhs, Legislative Director, AGPA, introduced themselves.

MR. WALKER stated that AGPA likes AGIA's open and transparent process because it guarantees a level playing field. Hopefully it will continue to be open to all participants, he said.

MR. WALKER explained that the Port Authority exists in part because the Stranded Gas Development Act was not initially effective. The idea was to provide a tax exempt structure to better the economics of a gas pipeline project in Alaska.

[1:49:33 PM](#)

MR. FUHS added that the testimony about going to more general objectives and staying away from specific applications is simply code for returning to the Stranded Gas Development Act. Furthermore, the comments about exclusivity are hard to take seriously because under the last administration those parties were happy with total exclusivity. The calls to return to a negotiated agreement with the administration is a call to return to a non competitive back room process.

MR. WALKER said another reason not to go back to a negotiated contract is that the contract had 30-45 years of concessions calculated to be in excess of \$10 billion and it didn't result in a project. We're pleased to see a new and promising way forward, he said.

MR. WALKER explained that the Port Authority was formed to:

1. build a gas pipeline
2. provide a stable source of energy in Alaska that isn't necessarily tied to a Lower 48 price index

3. keep pipeline and liquefaction associated jobs in the state
4. direct net-project revenue sharing: 60 percent to the state, 30 percent to municipalities, and 10 percent in energy related benefits to rural Alaska
5. make gas available in state at the earliest opportunity
6. supply gas liquids to in state markets to the greatest extent possible
7. provide market optionality for Alaska's gas

[1:57:50 PM](#)

MR. FUHS explained that port authorities are used worldwide to facilitate and manage huge projects. All the operations are done by the private sector so it's not a government operation other than the board of directors that ensures that operation is in the state's interest.

MR. WALKER emphasized that AGPA is the facilitator that will cause the gas pipeline project to happen. He displayed a slide indicating how and where industry leaders will be involved in the components of an AGPA project. The goal is to have a world class team available for the project, he said.

MR. FUHS added that the AGIA process creates an atmosphere that brings people together. Although you've heard that all the risk goes to the resource owner, typically these projects are based on a long-term contract to supply a certain facility. Somebody does have to make a firm transportation commitment, but it does not have to be the resource owner. The producers have testified that they would be willing to sell their gas to a third party and that is another possibility, but whoever buys the gas will have to make the commitment to move it in the project. It doesn't have to be the people that hold the leases on the North Slope, he said.

[2:02:15 PM](#)

SENATOR WIELECHOWSKI asked about the market for natural gas in the U. S and on the West Coast for the life of the project.

MR. WALKER said AGPA research indicates that there's a long-term need for natural gas in North America. Fields in Canada and the Lower 48 are in significant decline while there's an increase in demand. Large industrial users of LNG are very eager to have LNG from Alaska because the state has a good reputation, he stated.

SENATOR WIELECHOWSKI asked if he agrees with the ConocoPhillips economist who indicated that the U.S. is headed toward using coal and nuclear energy rather than natural gas.

MR. WALKER said what we hear and see doesn't match with what those companies are doing elsewhere around the world.

MR. FUHS added that the West Coast uses about 10.5 bcf/day. The new project there had one contract at 1 bcf/day and now they're going out for another 1.5 bcf/day. For a project like this, it doesn't really matter if general demand goes up or down because you're supplying a certain amount to a certain facility under contract.

2:06:50 PM

MR. WALKER displayed a map of the AGPA project and described the 48 inch line from Prudhoe Bay to the gas conditioning plant in Valdez. The economics are sufficient to pre-build to Delta Junction for a line through Canada if that takes place, but it could also be used for expansion. The LNG facility in Valdez has a fractionation facility that strips the propanes. Currently there's a premium market for that in Asia, he said.

CHAIR FRENCH asked how much gas the base case project proposes to move.

MR. WALKER said the base case is 1.2 with a maximum of .5 for in state so the total would be 1.7.

2:07:59 PM

MR. WALKER described the project status as follows:

1. The project route is permitted
2. The 12 senior permits have been acquired. AGPA purchased exclusive right to the Yukon Pacific Corporation several years ago and spent in excess of \$100 million to permit the route. State and federal rights-of-way, the federal environmental impact statement, and the LNG terminal permit in Valdez have all been received.
3. Bechtel Corporation supplied cost estimates and AGPA is in the process of updating the numbers for 2007.
4. The marine transportation/Jones Act - They received a MOU with the largest LNG shipping company in the world - Mitsui OSK Lines. They have 8 U.S. built LNG tankers for use as the initial shipping. Re-flagging may be required, but that shouldn't be an issue.
5. Access to Multiple Markets - The West Coast is the most obvious, but there are markets in Hawaii and the Pacific Rim. There are about eight West Coast projects that are in different phases of development. They're located in Mexico, California, Oregon, Washington and BC Canada. The

most enticing is the Sempra facility in Baja California, Mexico because it's currently under construction.

6. Anticipated financing is for 100 percent debt financing taking advantage of the federal loan guarantee. It's a benefit to the project and to Alaska.

SENATOR HUGGINS recalled someone saying they didn't anticipate LNG permitting anyplace other than the Gulf Coast in the future.

MR. WALKER said the Gulf Coast has been the most successful at getting permits for LNG receiving terminals, but FERC is more involved with permitting receiving terminals so that might change. The technology is also changing to address concerns that have been raised. Although only a fraction of the 45 applications for receiving terminals will receive permits, he's confident there will be at least one more permit on the West Coast. Even if there isn't, the volume of the terminal that's under construction in Baja is sufficiently sized for this project.

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MR. WALKER said AGPA has been advised that with the right kind of robust economics and the right kind of structure, a project of this nature can be done on a project financed basis. We believe that's available and we plan to take advantage of that, he stated.

SENATOR THERRIAULT noted that other testimony indicated that the firm transportation commitment underpins the financing for the project. It was suggested that if the pipeline company were to go bankrupt, the financier would look to the companies that made the FT commitments for payoff on the loans. You don't see that happening?

MR. WALKER said his understanding is that it would depend on how the contract is structured. Also, there's a federal loan guarantee for 80 percent of the cost of the project up to \$18 billion. A detailed response will be forthcoming, he said.

CHAIR FRENCH asked him to send a written response to his office and he would see that it's distributed to the committee members.

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MR. WALKER articulated the advantages of the AGPA project:

- It's an 800 mile pipeline that's 100 percent adjacent to TAPS and entirely within Alaska.

- The infrastructure that's already in place is a significant step in mitigating risk.
- LNG projects have lower overall cost overrun risk.
 - Each new liquefaction facility gets more efficient and we're comfortable with the cost estimates we've received. Also, contractors are willing to stand behind the numbers related to building a liquefaction facility.
 - The level of cost uncertainty for LNG marine transportation and re-gasification is low. We're dealing with ships that are already built and we know the transportation cost for shipping LNG from Valdez to Baja so there's no speculation on that.
 - The pipeline component has the highest degree of uncertainty with regard to cost overruns but the AGPA line is the shortest line at 800 miles.
- A pipeline that is one-third the length of another line has significantly less risk.

MR FUHS said the project is estimated to be \$10 billion.

MR. WALKER discussed Alaska's risk.

- Alaska could lose the U.S. markets to LNG projects that are beyond the study phase. If we miss the market, Alaska's gas could become stranded.
- The \$18 billion federal loan guarantee could be taken away. The AGPA project isn't 100 percent dependent on that but it certainly does help.
- The cost of construction rises over time.

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SENATOR THERRIAULT asked when the \$10 billion project cost estimate was last updated.

MR. WALKER replied it was in May, 2005. The estimate was \$8 billion for the pipeline and \$2 billion for the liquefaction.

MR. WALKER discussed the project economics.

- The LNG economics are robust. Econ One Research, Inc. shows an internal rate of return in excess of 30 percent to the upstream without tax concessions. It's a status quo project.
- This project brings the greatest benefits to the state.

- The economics are sufficient to pre-build to Delta Junction, which is a strong indicator of the robust economics of the LNG project.
- To have the LNG project go now is an absolute win-win scenario for Alaska.
 - It allows multiple markets. It would be a West Coast market initially, but in the future it could be on a world market. Also, when issues are resolved a later line could go through Canada.

MR. WALKER discussed the advantages of LNG from Alaska.

- The Alaska LNG project will benefit from an efficient, low-cost liquefaction operation.
 - The 40 degree ambient temperature will make the facility 30 to 40 percent more efficient than facilities in warmer regions because the gas is basically pre-cooled.
- Other LNG projects that have gas at tidewater typically have longer shipping times - some as long as 28 days. The Alaska LNG market is 5-6 days away, which is a significant cost savings. Also, not having the gas at tidewater is beneficial for distribution of gas along the way.
- Many other LNG projects have higher upstream costs due to complex, expensive field development. In Alaska 8.4 bcf/day is reinjected so there isn't the expensive upstream development.
 - There are associated costs, but it's not the same as a green field development on the upstream. Alaska benefits from substantial existing North Slope infrastructure and developed fields.
 - It's important to evaluate the entire project. ASPA has significant advantages that the other projects don't have.

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MR. WALKER described a right sized project.

- Gas requirements:
 - The proven North Slope gas reserve is 35 tcf.
 - The gas requirement for the initial phase of the Alaska LNG project is 15 to 25 tcf or 1.5 to 2.5 bcf/day.
- The maximum offtake for Prudhoe Bay under AOGCC Rule 9 is 2.7 bcf/day. That hasn't changed since 1977.

- LNG has about 2 bcf/day offtake. It decreases the cost of operation from reinjection and makes more oil available for thruput through TAPS.
- The Alaska LNG project will enable Alaska's gas to reach Alaskan's and other markets sooner than larger pipeline projects. This project fits within the market for LNG on the West Coast and it fits within the size of the permitted pipeline route. Also, it fits with the availability of the gas on the North Slope in volume and the offtake at Prudhoe Bay.
- AGPA provides market optionality as the project grows.

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MR. FUHS said AGPA supports Senator Huggins' request to AOGCC to address the issue of maximum allowable offtake.

CHAIR FRENCH stated for the record that he asked Mr. Norman about that recently. He indicated that some preliminary data has been published and they're continuing to work on the question.

SENATOR THERRIAULT asked if he's saying that gas offtake now may enhance oil recovery.

MR. FUHS explained that as a field gets older, more gas comes up compared to the volume of oil so oil production becomes limited by the gas handling capacity of the facility. Increasing gas handling capacity by 2 bcf/day would result in an immediate increase in oil production.

SENATOR THERRIAULT advised that last year he asked Department of Natural Resources personnel if anything could be inferred if the producers didn't propose additional investment for gas handling capability. He suggested that it's a good question for AOGCC to answer and then it should be put to the producers.

2:31:13 PM

MR. WALKER discussed suggested amendments to AGIA. He noted that some of the following have been addressed in the latest bill version.

- The same level of detail should be required for all projects. The latest version seems to address that.
- If the proposed offtake exceeds the maximum allowed under AOGCC Rule 9, someone should file an application to start the process to increase the limit.

- If the volume of gas that's needed is in excess of 35 tcf, the applicant should say what the exploration costs and the timeframe would be.
- There should be an analysis of the anticipated oil loss from Prudhoe Bay if the volume exceeds the AOGCC limit of 2.7 bcf/day.
- A timeframe for the project start up and completion should be established for all applicants.
- A current project cost estimate should be included with the application.

SENATOR THERRIAULT asked if the project start up wouldn't be reflected in net present value.

MR. WALKER said yes, which is why it should be included. A net present value analysis of the various proposals is necessary to see the true value of the project to the state.

SENATOR THERRIAULT recalled that the state agencies indicated that net present value would be the primary measure of the different factors.

MR. WALKER said that's good as long as there's a net present value calculation that considers timeframes. Also, there should be provision for an expedited judicial process in the event there's a challenge to the process or to the contract that's awarded.

CHAIR FRENCH agreed and said the committee is looking at ways to ensure that a case would leapfrog any other pending matter in front of the court.

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MR. FUHS highlighted a suggested amendment related to value added processing. If the project description includes an agreement to provide gas liquids within the state for value added processing, you should get credit for that because that will build an economy beyond the construction phase, he stated.

CHAIR FRENCH said he'd be happy to review proposed language on that point.

MR. FUHS said he also has proposed language to address project modifications as outlined on page 14, line 20. The way the bill is currently written it's not possible to modify a project to provide improved benefit to the state and you should be able to

do that. The administration doesn't object to the proposed language, he added.

CHAIR FRENCH asked him to give the proposed language to his staff.

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CHAIR FRENCH noted that Representative Olson joined the meeting.

SENATOR THERRIAULT said he would certainly like to see value added industry get started in the state, but it's difficult to award points to something that might or might not happen.

MR. WALKER suggested building a process into the contract so that when there is industry, it could bank on offtaking some of the liquids within the state.

SENATOR THERRIAULT asked if it's a question of a physical offtake.

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MR. FUHS explained that the gas on the North Slope is rich. In Cook Inlet it's 99.9 percent methane and on the North Slope there's methane, ethane, propane, and butane. The gas handling there makes it possible to actually customize what the gas offtake will be so it links up to the intended uses. He suggested you'd go at least as far down as propane. It receives a premium in the Asian market and it's the most likely petroleum product to be exported to coastal Alaska. He noted that ANGA has done a financial analysis on moving propane into rural Alaska to replace diesel. Ethane provides a feedstock for the plastics industry and butane provides a feedstock for butyl rubber, which is what most automobile tires are made of. We ought to at least be able to create those basic feedstocks whether you produce them to the final product or not, he said.

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SENATOR HUGGINS asked, on behalf of a knowledgeable constituent, if the terminus should be closer to MatSu, Kenai, or Anchorage.

MR. WALKER explained that the location of the LNG facility is the result of work the Yukon Pacific Corporation did. Going into Cook Inlet was studied, but the permitting agencies wouldn't allow it. Any effort to change the terminus would require proving wrong those 23 state and federal agencies. Doing that would remove the time advantages of having a location that's permitted right now.

SENATOR HUGGINS said his constituent would argue in support of making the spur line to Southcentral larger and just bringing it down. Because of the terrain and available workforce it's readily expandable.

MR. FUHS said it doesn't need to be an either or question. In fact, AGPA has a MOU with the Alaska Natural Gas Development Authority on bringing the spur line in. That proposal is a 24 inch line tying into the existing 24 inch line. There's no reason you couldn't also bring rich gas in for industry if it makes sense, he said. If ConocoPhillips wanted to modernize its LNG plant there'd be no problem; it'd bring the unit cost down for everyone in the system. The trick is to get production as high as possible and still have a project that's not too big to move forward within the available gas supply. That's what we mean by right sizing, he said. If someone wants to make the commitment to expand that's not a problem.

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MR. WALKER highlighted AGIA benefits toward advancing a gas pipeline.

- The rolled-in rates are good for Alaska's future. In Canada rolled-in rates are the norm and it would be unusual to have an adjacent project that's incremental.
- The \$500 million sends a very positive message about a project going forward.

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SENATOR WIELECHOWSKI said the testimony was refreshing and he's pleased that this alternative exists. The project is less risky, it's all Alaskan, it's quicker, and according to various studies it's as profitable. Expanding through Canada later is always an option. He said he hopes the administration looks at this project seriously.

SENATOR THERRIAULT asked what makes AGPA believe it can get approval to deliver gas liquids to overseas markets beyond the current export.

MR. WALKER replied we're not aware of any prohibition against gas liquids going to a foreign market and we're not aware of any shortage of propane in the North American market. The loan guarantee requires getting the natural gas into the continental U.S. but we haven't seen that requirement on the liquids, he said.

At ease from [2:49:09 PM](#) to [2:52:57 PM](#).

CHAIR FRENCH reconvened the meeting and announced the next item on the agenda is a presentation from ExxonMobil.

BILL McMAHON, Commercial Manager, ExxonMobil Alaska Gas Development Group, Anchorage, AK, described ExxonMobil's 50 year history working to develop the oil industry in Alaska. He said this has been a mutually beneficial relationship and commercializing gas on the North Slope will allow the relationship to continue for another 50 years. ExxonMobil holds the largest working interest at Prudhoe Bay and its current net production in Alaska is 150,000 barrels/day. Adding 1 bcf/day in natural gas sales—which would be ExxonMobil's share—would increase its worldwide daily gas production by more than 10 percent. Given the significant impact that this project could have, he said his company is ready to work with Governor Palin, her cabinet, and the legislature to move the project forward.

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MR. McMAHON said that as an illustration of commitment, ExxonMobil has spent more than \$180 million studying ways to commercialize Alaska gas. Since the 1970s we have evaluated LNG, gas to liquids, and gas pipeline alternatives. Based on these studies, we've determined that a producer gas pipeline would result in the best value for the state, the producers, and the nation. ExxonMobil is aligned with the governor, the legislature, and the people of Alaska regarding the overall objective. We are committed in moving the Alaska gas pipeline project forward.

ExxonMobil is ready to participate in a fair market-based competition. We understand the overarching goal of AGIA is to create open competition, but due to the prescribed conditions included in AGIA, it will not achieve that goal. A prescriptive bidding process will not allow the flexibility needed for individual applicants to weigh the risks associated with this basin-opening mega project and propose what is necessary to manage these risks. It's important that AGIA allow applicants to define how they would achieve the state's objectives rather than prescribing specific requirements.

To ensure the best results, AGIA should establish broad key objectives and allow the applicants the flexibility to meet those objectives and the flexibility in defining the requirements they deem necessary to make the project commercially viable.

MR. McMAHON suggested amending AGIA to make it is an objective driven process. Doing so would result in an open competition with the maximum number of applicants proposing innovative solutions. He recommended that the state define broad objectives and request proposals for how the applicants intend to meet or not meet those objectives. Evaluate the proposals and select the one that best serves Alaska's needs and if none meet the state's overall objectives, they can be rejected or the state could negotiate with the party that most closely meets those needs.

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MR. McMAHON said to understand the importance of using broad objectives it's helpful to review the project risk and issues surrounding the development that any applicant will need to address. Describing the project as a "world scale" undertaking with significant risk, he said the recent increases in construction costs have made the 2001 \$20 billion cost estimate too low. Furthermore, natural gas prices remain highly volatile and are now slightly less than in 2001. Other risk factors include cost overruns, schedule delays, construction conditions, regulatory uncertainties, and state fiscal uncertainties. The huge size of the project increases the complexity and, he cautioned, the size amplifies the consequences of poor execution.

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MR. McMAHON explained that large, commercially sound oil, gas and pipeline projects traditionally have obtained financing if they have strong sponsors, proven track records, and sufficient financial strength to provide sponsor equity and to backstop key project commitments. He opined that the key commitments for this project will take the form of firm, long-term gas transportation commitments. Those firm transportation (FT) commitments are binding obligations made by shippers to pay for the cost of reserving a quantity of gas capacity on a pipeline over a specified period of time.

MR. McMAHON said that FT commitments are needed to finance the gas pipeline project and must be provided by creditworthy shippers. In this case, the shippers will be the producers and the state's shipper. These substantial FT commitments, which may be for tens of billions of dollars, must be paid whether or not the gas is actually shipped and regardless of the price of gas in the marketplace. Through these commitments, the development costs and associated overrun risks are ultimately borne by the shipper.

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MR. McMAHON emphasized that the parties taking the risk need to be able to manage the risk. He expressed the view that the producers as shippers cannot make FT commitments during an open season unless they have confidence that the gas pipeline project can be built cost effectively and operated on a long-term commercially viable basis. He warned that the current prescriptive terms will preclude leaseholders from making a conforming proposal thereby denying the state the opportunity to consider terms from the largest stakeholders in the project's successful development.

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MR. McMAHON offered the view that operation and construction experience ought to be a significant consideration on projects of this magnitude. He advised that the producers have worldwide mega-project experience and have demonstrated success in meeting project objectives. In fact, ExxonMobil has a record of completing large projects within 15 percent of the cost estimated at the time of project funding. The combined experience and capability of ExxonMobil, ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc., will provide the best chance for delivering a successful project, he stated.

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MR. McMAHON relayed that the producers have extensive successful experience in Arctic environments. He noted that ExxonMobil's commitment to technology development has played an important role in advancing oil and gas development in Alaska. He attributed ExxonMobil's success to its research, technical development, and a firm commitment to safety, health and environmental care. In addition to its operating excellence, ExxonMobil has the financial strength to make this project a reality. Having maintained the highest credit rating for the past 88 years, ExxonMobil has the financial strength and flexibility to pursue opportunities worldwide through fluctuating economic cycles.

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MR. McMAHON reminded members that the Alaska gas pipeline project is a basin-opening project that will benefit the state and the oil and gas industry in Alaska. He opined that these projects are most successful when there is alignment between the host government and the leaseholders and on a very high level there is alignment between the three major producers and the state. ExxonMobil believes that a producer gas pipeline project

will bring maximum benefit because the producers and the state have the greatest incentive to control cost. Low capital and operating cost combined with lower treatment and transportation cost, results in a higher net-back value on the gas. He highlighted that the state will receive most of its revenue from the gas sales under the lease royalty agreements and production taxes, which are valued based on the netback received from the gas. He expressed the view that third-party owners do not share the same incentives because they can benefit from increased capital costs.

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MR. McMAHON stated that to mitigate the tremendous risks associated with this project, ExxonMobil must have fiscal terms that are predictable and durable before it can proceed. He relayed that ExxonMobil is willing to take the geologic, cost, and commodity price risks, but it cannot risk a change in the fiscal terms. That is of a different nature and totally beyond his company's control. If fiscal terms are subject to change, ExxonMobil cannot make a well-founded investment decision on behalf of its shareholders. Because of the large investment required to develop the gas pipeline, tax increases on oil and gas related activities during the life of the project could significantly impact the commercial viability of the project and offset the benefits, he stated. He reiterated that AGIA should allow market participants to put forth proposals on what is required to make the project viable. This competitive process will allow the state to consider the proposals that have the best chance of delivering on the promise of an Alaska gas pipeline.

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MR. McMAHON explained that AGIA must bring together the upstream and midstream to provide an integrated proposal. The reason they must come together is because the upstream pays for the midstream. Upstream means the revenue generated from the sale of the gas and liquids from the pipeline project. To calculate the revenue from the upstream, there must be clarity on the taxes and royalties from the beginning of the project. At a minimum any proposal must demonstrate how a successful open season will be achieved.

MR. McMAHON said that because the upstream inducements require significant modification, he would suggest leaving the issue open and allow an applicant to make a proposal to address those terms. AGIA prescribes activities that must be completed in a particular timeframe, which isn't consistent with good project

management practices. If the project is commercially viable, milestones are unnecessary. AGIA generally lacks specifics on key fiscal terms and other requirements. To address these gaps commissioners are given broad authority to adopt additional requirements and establish regulations. This would create significant uncertainty, he stated. Finally, the parties must have an efficient and impartial means to handle disagreements. ExxonMobil believes that project related agreements ought to provide for binding neutral arbitration as a mechanism for dispute resolution.

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MR. MCMAHON stated that ExxonMobil agrees with some of the changes that have been made to AGIA including: making the state's entire capital contribution a bid variable; beefing up evaluation criteria; recognizing the need to include terms in the contract; and requiring legislative approval of any license award. Other changes will limit bidders by eliminating confidentiality protection for a licensee's proprietary and trade secret information and requiring bidders to forgo the right to challenge an improper award. At this stage AGIA is too prescriptive to solicit quality market-based bids that are necessary to move the project forward, he opined.

MR. McMAHON stated that his company is 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 outlined above to allow the project to go forward. ExxonMobil suggests amending AGIA to include a broad objective-driven framework. Applicants should be allowed to propose how to best meet those objectives and to identify state requirements to advance the project. Such a process will bring more viable applications, create more competition, and allow the state to select the proposal that delivers the most value. ExxonMobil is ready to participate in a competitive, open, and transparent process as outlined above.

CHAIR FRENCH asked Mr. McMahan to send a copy of his statement for the record.

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SENATOR THERRIAULT asked if participation by an ExxonMobil affiliate might satisfy the Canadian demand for involvement in the line running through that country.

MR. McMAHON replied his company hasn't focused on that at this point, but ExxonMobil's interest in Canada would be held by a

Canadian affiliate. We're interested in working with any parties that add value to the project and that includes Canadian enterprises, he added.

SENATOR THERRIAULT said he understands that ExxonMobil's corporate view is that Enbridge and TransCanada don't add value, but it appears that they could satisfy this Canadian demand.

MR. McMAHON replied, "We continue to have dialog with Enbridge and with TransCanada today."

SENATOR WIELECHOWSKI asked if the request for locked in rates doesn't ask Alaska to assume huge risk.

MR. McMAHON said establishing the fiscal terms means talking about how to split the revenue from the project between the state and the producers. Given that this is a natural resource project, there will be fluctuation in the actual revenue that each party receives based on the volatility of natural gas prices.

SENATOR WIELECHOWSKI commented that ExxonMobil would essentially like to shift its risk onto the state.

MR. McMAHON replied we want clarity on what the split of revenue will be over the life of the project.

SENATOR WIELECHOWSKI asked what type of assurance ExxonMobil can give that it can actually access its gas under the Prudhoe Bay Unit Operating Agreement.

MR. McMAHON said we'll need to work with AOGCC for gas offtake rates and we already have commercial agreements among the Prudhoe Bay owners that govern the taking of gas so we're confident that we'll be able to take our share of the gas from Prudhoe Bay.

SENATOR WIELECHOWSKI asked if he's familiar with the Prudhoe Bay Unit Operating Agreement.

MR. McMAHON said no.

SENATOR WIELECHOWSKI relayed that there are differing opinions as to what producers can and cannot do under that agreement. Do you absolutely know you can take your gas?

MR. McMAHON said with alignment among the Prudhoe Bay leaseholders, we're confident we can take our gas.

SENATOR WIELECHOWSKI relayed that many of his constituents are asking why ExxonMobil should be allowed to participate in the gas pipeline when it hasn't paid for the Exxon Valdez spill and it hasn't developed Pt Thomson. He asked for a response.

MR. McMAHON replied:

As far as the Valdez oil spill, ExxonMobil has paid all the damages associated with that—the actual damages ordered by court and voluntarily, many within a year of the spill. The current dispute that is open right now are punitive damages appropriate in this case. That's the issue that's being worked through the courts as we speak. And so we think that that's best resolved in the courts. As far as Pt. Thomson's concerned, we are involved in litigation over the Pt. Thomson field and I'm really not at liberty to comment on Pt. Thomson.

SENATOR HUGGINS asked for a comment on an international project that was canceled when it was \$3 billion over budget.

MR. McMAHON said he isn't familiar with it.

CHAIR FRENCH asked if ExxonMobil needs fiscal stability on taxes across the spectrum.

MR. McMAHON said yes. Providing stability on just one form of tax wouldn't be sufficient because the other taxes could be increased to offset the fixed rate.

CHAIR FRENCH suggested ExxonMobil think about another alternative. "You're forcing us to go to an all Alaska line or some other route that allows us to actually get our gas to market without your participation because of your request for what I perceive as a political impossibility." The state derives 90 percent of its income from oil revenues so giving you what you're asking for would threaten schools, roads, public safety, and everything else. Even then there would be no guarantee that you'd start digging on the pipeline, he said.

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MR. McMAHON acknowledged the statement.

SENATOR THERRIAULT relayed that in 2001 ExxonMobil resisted when it was asked to help with financing a northwest pipeline

project. At that time the Secretary of Energy asked the major producers to give the builder some kind of loan guarantee even though they were barred from equity ownership. Basically you told Congress that if you were going to participate you'd ask for a waiver and you'd want some equity, but you wouldn't give a loan guarantee. Now the issue is that the FT commitment really finances the pipeline and is akin to a loan guarantee. The argument then and the argument now aren't consistent, he said.

MR. McMAHON explained that in 2001 there was a different regulatory regime for the natural gas business in North America and the concept of FT commitments didn't exist. At that time pipeline companies were a merchant transporter and as such they bought, transported, and sold gas into the markets in North America. Producers were prohibited from that business. Since that time the natural gas pipeline business has been deregulated. Now the pipeline companies are prohibited from being a merchant; they transport gas for a fee and someone else holds the shipping rights.

SENATOR THERRIAULT said there's the suggestion that FT commitments are like a loan guarantee, but there's already a separate federal government loan guarantee. Why are we being told you're running significant risk? If the pipeline were to cease operation it doesn't seem that you'd necessarily be responsible for paying off the construction loan, he said.

MR. McMAHON explained that if the pipeline wasn't operational that would be a force majeure event and under the FT agreements his company wouldn't be required to make the payments. He further explained that FT commitments are ship or pay and the corporate balance sheet is on the line for that. The federal loan guarantee would come into play only if all the shippers failed to make their payments. Financiers will look first to the holders of the FT commitments.

SENATOR THERRIAULT asked if the federal loan guarantee wouldn't be available to pay off the construction loan if the pipeline company were to declare bankruptcy.

MR. McMAHON said he would defer to the ExxonMobil financing experts.

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CHAIR FRENCH advised that the committee would be happy to receive a supplemental written response.

SENATOR THERRIAULT noted that ExxonMobil's 2001 congressional testimony included the following statement: "There must be assurance that the Canadian segment will be financed and completed without our involvement." There seems to have been a different world view at that time, he said.

MR. McMAHON said it was a different world given the different regulatory regime.

SENATOR WIELECHOWSKI asked if his company would agree to put its gas in the line if it isn't the licensee and the project is economically viable.

MR. McMAHON said we'll assess the project that's proposed when an open season is announced. ExxonMobil has a duty to its shareholders and it has obligations under its lease agreements with the State of Alaska. Those obligations will drive our participation in an open season, he stated.

SENATOR WIELECHOWSKI asked if his company has analyzed whether or not this project is profitable.

MR. McMAHON said we don't believe the project is commercially viable under the current fiscal regime.

SENATOR WIELECHOWSKI asked if his company had calculated any rates of return or net present values.

MR. McMAHON replied we analyze our business and make investment decisions on a proprietary basis.

SENATOR WIELECHOWSKI noted that the state has talked about rates of return averaging anywhere from 29.8 percent at \$3.50/mcf to 90 percent at \$8. Is your analysis different than that?

MR. McMAHON explained that determining the commercial viability of a project has more to do with risk than a single number. There's cost risk, price risk, completion risk, and fiscal risk.

[3:41:24 PM](#)

SENATOR WIELECHOWSKI asked if he had looked at and agrees with the state's report or the EconOne analysis from last year.

MR. McMAHON said he hadn't seen the state report. He did look at the EconOne analysis last year and his company does not agree with it.

SENATOR WIELECHOWSKI said this is the first testimony he's heard that the project isn't commercially viable.

MR. McMAHON said his company is willing to take on many of the risks associated with the project including geologic risk, cost risk, and commodity risk. However, fiscal risk must be addressed and that's what his company hopes to achieve through the AGIA process.

SENATOR WIELECHOWSKI asked if his company doesn't take on fiscal risk every day in other countries.

MR. McMAHON said yes, but the sheer magnitude of this project makes it different and that's what is driving the quest for fiscal stability and predictability.

SENATOR WIELECHOWSKI asked if he'd agree that the all Alaska line would be less risky.

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MR. McMAHON replied ExxonMobil has looked at LNG, gas to liquids technology, and gas pipelines and it believes that a gas pipeline to the North America markets offers the most promise for a commercially viable project for the producers and the state.

SENATOR WIELECHOWSKI reminded him that he just said that is a much riskier project.

MR. McMAHON said there is extreme risk associated with a project of the magnitude envisioned.

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SENATOR THERRIault said you don't get the type of certainty you'd like in western democracies; you only get it in areas of the world where it's virtually meaningless. You don't get it here because of constitutional prohibitions and because of the governmental system you're able to participate in. The proposed reserves tax is a case in point. When that was on the general election ballot last year, ExxonMobil participated in the "Vote No" campaign and the citizens in the state did in fact vote no. That governmental system keeps political risk and therefore financial risk in balance. There isn't any reserves risk because there's gas coming out of the ground every day. There is cost risk because the price of steel could escalate, but you don't have to build the upstream part. That pipe is built, the gas is coming out, and the pipe's been amortized. It seems like there

are a number of things in place that make the risk manageable so the claim that this is too risky just doesn't ring true, he said.

MR. McMAHON said if this project were in Texas, the United Kingdom, or Australia his company would seek the same predictable and durable terms. He then read the following:

Most western democracies have broadly diversified economies and when there's a need for more tax revenues, those governments have many options available to them on how best to raise the needed additional revenue. For example, the United States changes the rate of personal income taxes as often a vehicle that's selected. There's no need to target a particular industry. We need fiscal predictability in Alaska for exactly the same reasons that we insist on fiscal stability in these other political jurisdictions. The temptation to target the predominant industry to provide additional revenue is always there and fiscal stability provisions prevent these other host governments from responding to that temptation.

SENATOR THERRIAULT asked if his company couldn't divest itself of some of the risk by selling at the wellhead.

MR. McMAHON said ExxonMobil is open to selling its gas at the wellhead to any company that offers an attractive proposal through a commercially viable project.

[3:49:55 PM](#)

SENATOR WIELECHOWSKI asked if it's fair to say that ExxonMobil will not be participating in the bid if AGIA stays the same.

MR. McMAHON said if AGIA remains in its current form his company would not be able to make a conforming bid.

SENATOR THERRIAULT asked if ExxonMobil wouldn't enter into active negotiations with the project proponent about ways to manage risk and use its corporate expertise to oversee the project even though it wouldn't be an owner.

MR. McMAHON said it would depend on the structure of the open season and the types of bids the project proponent would accept. He said he doesn't know if it's a common practice or not.

At ease from [3:52:30 PM](#) to [3:58:58 PM](#)

CHAIR FRENCH reconvened the meeting and announced the next item on the agenda is a presentation from ConocoPhillips.

WENDY KING, Manager Alaska North Slope (ANS) Gas, ConocoPhillips, Anchorage, briefed the committee on ConocoPhillips' business in Alaska and stated that her company is committed to finding a way to develop the ANS gas resources and is eager to find a framework by which the project can be advanced. Although the resources committee made some thoughtful changes, additional change is necessary, she stated.

[4:00:54 PM](#)

MS. KING displayed a chart indicating that since 1970 ConocoPhillips has studied a number of different technologies to market ANS gas resources. Since 2000 it has focused on a gas pipeline project through Alaska and Canada for delivery to North American markets. Working jointly with the other major producers, it has spent \$125 million on this project. During 2002, 2003, and 2004 it was involved in federal legislation. Since 2003 ConocoPhillips has worked with the State of Alaska to develop a framework to advance the gas pipeline project and that effort continues today. Dialog and balanced accommodation of reasonable concerns are essential to create the alignments necessary to move this project forward, she stated.

[4:02:34 PM](#)

MS. KING displayed a graph demonstrating that the Alaska gas pipeline project will be significantly larger than any other North American project advanced since 1997. We know that this project will cost more than \$20 billion, but we don't know how much more, she said. The sheer size and scale creates new risks that even those of us in the industry don't normally look at when analyzing a \$2 billion to \$3 billion project.

SENATOR THERRIAULT asked if the graph is showing the cost into the Alberta Hub as \$14 billion or \$15 billion.

[4:05:02 PM](#)

MS. KING explained that the graph is intended to clarify—with the 2001/2002 cost estimate—how much of the project is from Alberta to Lower 48 markets. It doesn't factor in cost estimate increases so the actual breakdown to Alberta versus Alberta to the Lower 48 is unknown. Actually, she added, there are three alternatives for that second leg. The first involves building

new pipe, the second expands the existing pipelines, and the third alternative uses existing capacity. We haven't presupposed any of the alternatives, but that commercial decision will be addressed as the project schedule advances, she said.

[4:07:08 PM](#)

MS. KING referenced the DNR perspective of the project economics and said those numbers imply that the gas sales via a third-party pipeline are wildly economic and that the internal rate of return (IRR) would drop significantly on an integrated basis if an affiliate owned a corresponding share of the pipeline. Also, the IRR figures assume that the producers' economics aren't affected if the capital investments in the pipeline are made by an unaffiliated company. This ignores the fact that the shipping commitments are the most likely foundation for financing the pipeline. It's not the credit of the pipeline that will make this pipeline project go, it's the credit of the shippers, she stated. Furthermore, the numbers don't include the uncertainties that it costs to explore, find, and develop the gas to get it into the midstream portions of the project.

[4:08:57 PM](#)

SENATOR WIELECHOWSKI asked what the standard rate of return is for an upstream producer in oil and gas.

MS. KING replied she hasn't seen a standard rate of return on projects she's worked on. Her company looks at a number of financial metrics such as long-term cash flow, discounted cash flow, profitability indexes, reserves, and cost per barrel. Those metrics are weighed against the risks and uncertainties to determine whether or not the risk/reward balance is appropriate to make a stand-alone investment decision.

SENATOR WIELECHOWSKI asked what the rate of return was on the \$2.2 billion that ConocoPhillips made in Alaska last year.

MS. KING said she would do some research and supplement the record.

SENATOR THERRIault said you make it sound as though an FT commitment is almost a loan guarantee to the financial markets that finance the line and I don't believe that's true.

MS. KING said her understanding of the financing is that a pipeline company asks for ship or pay commitments. That is a promise to pay for a certain capacity over a specified term regardless of whether gas is shipped down the pipeline or not.

The pipeline entity will take that shipping commitment to the bank and improve its ability to finance the project.

SENATOR THERRIAULT said his understanding is that the pipeline entity shows the shipping commitment to the banker as proof that the project is economically viable. ConocoPhillips' obligation to pay is tied to the units that are shipped down the line; it is not a commitment to pay the banker. That long-term obligation to ship and pay may be a drag on the corporate balance sheet, but you have the upside of finally booking the tremendous reserves as an asset, he said. If the pipeline were to go bankrupt, ConocoPhillips wouldn't be obligated to pay the bank that financed the pipeline. Your company is only obliged to pay as the units are actually shipped.

MS. KING said she isn't familiar with the term "booking the value of the reserves," but her company doesn't realize the financial value of the reserve until it's produced. The second point is that if ConocoPhillips makes a shipping commitment it is obligated to pay that pipeline entity even if it is unable to get the gas into the pipeline. She acknowledged that she doesn't know what course of events the bank follows if a pipeline company defaults on a loan, but those shipping commitments were used to get the financing so there has to be a link. "I'm happy to follow up with our experts that are coming in here and try to get more back to the committee on that," she said.

CHAIR FRENCH said we'd be happy to have you supplement the record.

SENATOR THERRIAULT mentioned an article that talked about multinational corporations that were having trouble replacing reserves and commented that a company that isn't replacing reserves will eventually go out of business. Investors really look at that so it's got to be tremendously important to your company, he said.

MS. KING said she understands what he's saying about reserve replacement, but she isn't they're speaking a common language when talking about "booking the reserves" versus "booking the value of the reserves."

[4:19:08 PM](#)

CHAIR FRENCH noted that Senator Joe Thomas had joined the meeting.

MS. KING displayed a slide outlining project risks. Steel and labor costs are on the rise so the \$20 billion cost estimate could be significantly higher by the time actual construction begins.

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SENATOR WIELECHOWSKI reviewed the graph and said he's not sure it's fair to use cost figures back to January 2001 when her company was prepared to enter into a contract in May 2006. That's a more appropriate starting point, he opined.

MS. KING explained that ConocoPhillips was mindful of what had happened to project costs as it worked through the different tax and royalty terms associated with the last proposal. But it's my understanding that we aren't working under the old proposal, she said. We've been asked to find a new framework to advance the project and we're willing to do that. We're simply pointing out that there are uncertainties and risks associated with this project that we'll be considering as we try to find a balance. I believe we can bridge the gap, she said.

SENATOR WIELECHOWSKI said he's sure ConocoPhillips wouldn't have entered into a contract in May 2006 using January 2001 steel and labor costs estimates. Those increases had to be factored in somehow, he said.

MS. KING said when ConocoPhillips was involved with the negotiations last year it did the appropriate work to assess the uncertainties and risks. That was a proposal that would allow the project to go forward. Clearly people don't want to work off that old proposal now so her company has to find a new balance. She explained that ConocoPhillips uses a gated, decision-making process and it is not at a decision gate right now. A lot more engineering is required before the actual project sanction decision.

[4:26:52 PM](#)

MS. KING said price is another project risk. Predicting natural gas prices is challenging and it's risk that is borne entirely by the shippers. A pipeline entity isn't exposed if it has firm shipping commitments because it will get paid day in and day out. Other risks and uncertainties include: world-scale logistics, world-scale material procurement, labor availability, weather, reserves and deliverability. With these risks and uncertainties, she questions whether any entity is capable of guaranteeing an economic return on this project. We are willing to

guarantee assumptions in our work and back them up in a contractual arrangement, but is a pipeline entity willing to come up here and build this project without firm shipping commitments? Even if an entity said yes, could it get financing?

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SENATOR THERRIAULT said with regard to price risk he recalls that when ConocoPhillips acquired Burlington Resources, Inc., analysts put a price per unit of gas at \$6 or \$7 based on the cost of acquiring those reserves. That has to say something about what you thought the price might do going forward, he said. Under the old contract, Mr. Van Meurs proposed a risk sharing arrangement such that the state would pick up some risk on the down side and in return it would share on the up side. The producers said no, which is another indication that you thought it was more likely that the price of gas would go up. With regard to reserves risk, Prudhoe Bay is a lower risk than others because it's probably the largest and most well-understood basin in the world in terms of getting the resource out of the ground. As far as tax risk is concerned, ConocoPhillips in particular indicated it was ready to strike a deal before long-term certainty on oil was added to the deal. If you look at the things that are being highlighted as high risk, there are indications that perhaps that isn't the corporate view, or sources of information have helped to mitigate those risks, or the state has actually offered things to mitigate some of the risk and your company declined, he stated.

MS. KING said after the Burlington Resources acquisition she recalls that some of the quotes were only partial quotes. Although commodity price risk is something that ConocoPhillips takes on, there is a distinction between short-term and long-term price forecasting. With regard to reserves and deliverability risk she explained that there's clearly risk with deliverability. Even when you're working with known reserves, producing has associated risks. With regard to the price differential payment, she explained that it was part of a past proposal that related to upstream cost allowance.

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SENATOR WIELECHOWSKI commented it's risk versus reward. You're in the business of potentially earning up to 100

percent return and you ought to keep that in mind when you talk about risk. The rewards are huge.

MS. KING pointed out that the authors of AGIA recognized that the licensee could see the project as uneconomic in the future. If that weren't the case there wouldn't be a provision to set up an arbitration panel to deal with that issue. That is a reflection of the risk associated with this project. She continued to say:

It is important for us to reduce the differences in our perceptions about the economic drivers and risks on this project. It is also vitally important to have a common understanding about what gas resources we have and how they are used. ConocoPhillips has a 36 percent working interest in Prudhoe Bay that represents a majority of our known resource on the North Slope. Prudhoe Bay is circulating approximately 8 bcf/day gas into that producing oil reservoir. That gas serves to keep the reservoir pressure up so more oil can be produced. Some of that gas is converted to miscible injectant and is injected into Prudhoe and other reservoirs to improve oil recovery and some of that gas is blended with oil for shipment as NGLs—natural gas liquids—that go down TAPS.

We have invested billions of dollars at Prudhoe Bay to produce more and more and more oil from that field. And the Prudhoe Bay gas has been and continues to work hard to produce more oil. Neither the gas nor the owners are sitting there idle right now. I am most disappointed in talk about litigation for getting a gas pipeline. I see litigation as a lose lose proposition. I'd rather see a process by which we're creating work for engineers rather than creating work for lawyers. As a member of the House Minority described it, they saw it as the state's nuclear option. I actually agree. While we are fighting out litigation, costs could be continuing to rise, gas demand could be destructed and we'd be accomplishing nothing that could get us closer to make this project a reality.

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MS. KING displaying a graph that reflects the 10-year project timeline after AGIA. She highlighted that open season is from 18 months to two years after the project planning commences. During the permitting and engineering phases the focus will be on project costs and mitigating risks and uncertainties. Almost every year there will be a critical decision-gate and if the project still looks viable, the next phase is started. Roughly, it was estimated to cost \$1 billion to get through the first four years. At that point you make the decision to move to the construction phases. She advised that is the 2001 \$19 billion cost estimate.

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CHAIR FRENCH asked if the \$1 billion is shared among the three producers.

MS. KING replied it's \$1 billion gross.

CHAIR FRENCH asked where the FERC certificate is indicated.

MS. KING pointed to the two yellow boxes at the top of the graph. The first is when you file the FERC and NEB certificates and the second one is when you receive the FERC and NEB certificates. The project sanction decision would be made after receiving the FERC certificate.

CHAIR FRENCH asked who makes that separate project sanction decision.

MS. KING said on a project of this magnitude the project sanction decision would go before the board. FERC could put conditions on a certificate so you'd assess whether or not those conditions change the economic viability or risk/reward balance of the project.

CHAIR FRENCH said from a timing perspective, the decision would fall hard on heels of the FERC certificate. That's when you make the decision to commit money for construction.

MS. KING said yes; but the parties would need the time to do due diligence to make that huge investment decision.

[4:43:35 PM](#)

MS. KING displayed a "pipe" graph of front end loading and cost estimates. She explained that the feasibility phase will take about two years and cost about two percent of the total project. That's where preliminary design is done and fatal risks are

identified and mitigated. This phase provides the best opportunity to spend good money on engineering that will reduce costs later on, she said.

Once you move from the feasibility phase into the design phase you'll spend about five percent of the total project cost. For this project that's when you'd get the major permits. You'd be finishing the design optimization and you'd have about ten percent of the detailed design complete. At that point you'd be implementing risk mitigation plans. While advancing the engineering, environmental, and permitting work, the goal is to try and define the project more and reduce uncertainties.

The execute phase is when you're actually out there and construction is ongoing. At that time the risk mitigation options are limited and expensive. If the upfront work isn't right, this phase will be expensive.

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MS. KING stated that the open season is critical to the project because: it allows open access to the pipeline; it demonstrates no discrimination; it's required by ANGPA in Section 103(e); it establishes the demand for capacity, which impacts size, design, and the cost of the pipeline; and it supports whether or not the project is commercially viable and can get financing.

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SENATOR HUGGINS said in his view the binding open season is the critical event. He questioned what might be more important.

MS. KING said an open season, receiving the FERC certificate, and making the project sanction decision will all be critical milestones.

SENATOR HUGGINS noted that ConocoPhillips shows receiving the FERC certificate in about 4 years and AGIA estimates submitting the FERC application in about five years. He asked for help in understanding the difference.

MS. KING recalled that the only specific timeline in AGIA is that the initial open season is to be concluded within three years. The five-year timeline accommodates the circumstance where a party isn't ready to move into the execution phase. The FERC certificate has been received, but the party hasn't been able to receive credit support and/or shipping commitments.

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MS. KING expressed the view that the current structure of AGIA hinders competition and creative alternatives. Why would the state want to block alternative projects instead of letting the free market work the most efficiently? For all practical purposes, it's difficult to see how an alternative project could be advanced any time over the next decade, she said. The licensed project assurance clause in Section 540, Senate version page 22 is particularly problematic with respect to fair and open competition. The provision severely constrains the state's right to change tax and royalty terms, which is a contractual arrangement, for a project other than the licensed project. Even when the licensed project is not moving forward or is fully subscribed for over a decade. It also creates litigation exposure to the licensee. The word "preferential" could be easily disputed if the licensee was not satisfied with the state's actions, she said. The benefits of the AGIA coordinator and streamline permitting are exclusive to the state's chosen winner, but what if the winner can't deliver on the project that was promised in the application? The state could be tied up for a decade with an entity that was picked before most of the front end engineering design work is done, she said. Also, an alternative project could experience difficulties in getting their permits done efficiently or face more burdensome conditions if the state didn't want to cooperate with the alternative project.

MS. KING said she's been asked if AS 38.05.020(b)(9) offers an alternative vehicle for streamlined permitting for an alternative project. She reviewed the statute and wonders why the administration developed the AGIA coordinator position and mirrored it so closely to the federal legislation. Clearly, the powers of the coordinator with respect to the discretionary authority of the various state agencies—the Section 410—are not available under that statute, she said.

4:52:04 PM

MS. KING drew attention to the federal streamline permitting process that would apply to any project that is being advanced. In passing the Alaska Natural Gas Pipeline Act in 2004, Congress clarified that the pipeline application process should be market-driven and that the streamline permitting be available to any project sponsor. Instead of creating disincentives for some projects and special preference or rights for other sponsors, Congress ensured that the competition would be on a level playing field. She said we request that these sections be amended to make it clear that other projects could advance.

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MS. KING questioned why the state would be so prescriptive in the bid requirements. In particular, she drew attention to Section 43.90.140 on page 4, line 23. Under the provisions outlined, an applicant would be required to demonstrate to the administration's satisfaction that each of the requirements was met before the bid could be reviewed by the public and the legislature. Any bid that failed to meet even one of those requirements would be rejected as a non-conforming bid even if that bid brought the best overall solution to the state and to the challenges facing this project.

MS. KING expressed concern with the prescriptive and narrow in terms of: the project size receipt and delivery points; the project cost and tools; and work commitments. She asked how you balance the fact that many of those requirements are going to get passed on to the shippers. Also, what happens when the applicant can't deliver what was promised? We're concerned that the current bid process encourages bidders to bid high and then beg forgiveness rather than to bid realistically, she said.

MS. KING suggested changing the current list of bid requirements to bid variables or making them objective based. That would be consistent with the administration's goal of a fair and transparent process, but it would allow companies like ConocoPhillips to use its experience and creativity in bringing a solution forward. The state does not need to accept any bid unless it meets the needs of Alaska, she said. With regard to the "must haves," the state could say it has these objectives and request a company bring the most creative solution forward to meet those demands. This would create more alternatives for the state and it would give the state the right to reject the proposal if it doesn't meet its needs, she said.

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MS. KING expressed concern with the resource package defined in Sections 43.90.300 to 310 and 320 and reiterated that risk associated with tax and royalties has always posed the greatest obstacle to a gas pipeline project. We need to find a vehicle to work through the resource issues because those sections wouldn't be in the bill if the administration had not recognized that changes were needed. We appreciate that the administration proposing the ten year stability provision, but we had understood that the issue of fiscal stability and predictability would likely be decided by the Alaska Supreme Court. Although the bill promises to make some changes, the current form would

in fact force the resource owners to accept the future regulations albeit in contractual form.

MS. KING said the bill promises a degree of protection against changes on the gas production taxes, but it doesn't identify the protected production tax rate and the period of relative stability is insufficient for a project of this magnitude. Also, there is no protection against increases in other taxes that may be aimed at circumventing that protection. ConocoPhillips suggests converting the resource package to a bid variable where resource owner/applicants can propose the resource terms and the public and the legislature can review them. This will provide an option by which the public and the legislature can see the midstream and the resource sides that provide a foundation for the project to go forward.

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CHAIR FRENCH said if we were to take your advice and make the resource inducements bid variables, what would it do to your open season posture if you proposed total tax stability for 30 years and the legislature rejected it?

MS. KING said if the resource inducements were expressed as bid variables and the state wasn't satisfied with the proposal, she hopes that would set up a vehicle for working through the issues prior to an open season.

SENATOR WIELECHOWSKI said he suspects that if there are bid variables, the contract will be exactly the same as last year and that wasn't acceptable to Alaskans.

MS. KING replied ConocoPhillips is on record saying it was willing to make changes to address the public comments. The current difficulty is that there isn't a vehicle for working through those issues. It's particularly problematic to deal with the complexity of those issues in this forum, she said.

[5:02:11 PM](#)

MS. KING displayed a slide of the exploration and permitted well sites on the North Slope between 2000 and 2007 and said as the state's largest explorer, ConocoPhillips wants to ensure that the pipeline can accommodate new gas on a fair and reasonable basis. The best way to encourage more exploration is to get the pipeline built in the first place, she said. It's a concern that the discussion about tolls and tariffs has become confusing, but in her mind it's clear that FERC is going to serve as the

adjudicator about issues regarding rate treatment and the expansions.

CHAIR FRENCH asked if the state automatically gets a seat at the table to argue its case to FERC regarding rates.

MS. KING said she expects that the state would have a role.

[5:04:24 PM](#)

SENATOR THERRIAULT said he can't speak specifically to the state's standing, but because the rate impacts the state's royalty and taxes it would always have seat.

MS. KING questioned whether all the state's promises to explorers are actually eliciting the desired behavior. She pointed out that the explorer issues have been debated in federal legislation and before FERC. Both times a balance was struck and there is still no drilling so why would a company drill now when the state continues to push to provide guaranteed subsidized rates for those that defer the decision to drill. She expressed the view that if some of those companies had drilled wells in their gas prospects, perhaps more gas would have been found and that could be helping to improve the viability of the project right now.

MS. KING said the mandated expansion provisions in ANSPA Section 105 are unprecedented. If a shipper is willing to sign up for firm shipping commitments, and can demonstrate that the expansion won't require others to subsidize it, FERC can order an expansion. She said there's no problem with a party showing up and making a firm shipping commitment even if they don't have gas right now. The real issue isn't access; it's the cost of the access.

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SENATOR WIELECHOWSKI noted that ConocoPhillips was in this same position years ago when it was forced to sell Milne Point because it couldn't afford to pay the incremental rates on the tariff. We're trying to avoid that sort of situation because it's not good for either the state or an explorer he said.

MS. KING said she's not aware that ConocoPhillips was forced to divest of Milne Point.

SENATOR WIELECHOWSKI read a statement from the ConocoPhillips CEO stating that it broke his heart to trade Milne Point, but it

was necessary because the pipeline tariffs took away the value of the property.

MS. KING said she doesn't know the specifics of the Milne Point trade, but she does know that Congress has given FERC the right to mandate an expansion on this pipeline and FERC has said there is the rebuttable presumption of rolled-in rates. We aren't challenging that issue, she said. ConocoPhillips believes that if gas is found and there's need for an expansion there are vehicles by which parties can get access to it. The issue here is who will pay for that expansion. Through AGIA the state asks the initial shippers, including the state, to be willing to subsidize other companies' exploration efforts. You're asking the state to consider subsidizing the federal government if the expansion comes from the federal waters of the Beaufort Sea, she said.

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MS. KING said ConocoPhillips does not oppose rolled-in rates; it is simply proposing that FERC adjudicate the issue. According to Order 2005 the objective of the Act is "to adopt rolled-in treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found." She posed several hypothetical examples to highlight concerns related to presupposing the FERC process via AGIA.

MS. KING said there are a couple of key questions related to expansions. The first asks what happens when an expansion is particularly small. In that circumstance it's possible that the incremental costs and incremental fuel could be higher. She suggested that the parties would want to argue before FERC about whether or not that expansion is a subsidy. Another case might relate to fuel use. In compression expansions, fuel usage depends on the amount of gas that's moving through the compressor and down the pipe. Clearly you would want to look at the cost of fuel.

CHAIR FRENCH asked if it would lower her anxiety if the cost of fuel were included in calculating the expansion costs.

MS. KING said her anxiety will be lower when FERC actually plays the role it is intended to play.

CHAIR FRENCH said it strikes him that it's necessary to incorporate fuel cost as part of a legitimate expansion.

MS. KING said fuel is clearly a component that FERC will review when it decides how to handle the rate treatment. Continuing with the presentation she described sequential expansions and pointed out that after several expansions the in-field compressor stations might not be in the optimum locations.

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MS. KING said ConocoPhillips supports the state in its desire to incentivize North Slope exploration and believes that the state already has the tools to motivate and enhance expansions. Clearly, there are royalty reductions, tax credits and other alternatives that the state can look at in specific cases to determine the best way to "incent" the exploration. Also, the state could make a capital contribution to the future expansion. She said it's inappropriate to require existing shippers to subsidize the parties that did not take on the initial risk. Signing up for a 20-year shipping commitment is greater risk and asks for greater exposure than asking a company to drill one exploration well that might be a dry hole. We can't let unknown gas prospects drive the timing and the development of approximately 35 tcf of known resource and the largest private construction project in North America.

[5:18:04 PM](#)

MS. KING suggested the following changes to AGIA.

- Convert AGIA bid requirements to bid variables because doing so provides an option for potential bidders to include certain commitments and uncertainties in exchange for others. This approach will also create an avenue by which resource owner/applicants can propose packages on the resource terms. It will provide more bidders for the state to consider and the state would still have the ability to reject the bid that doesn't meet objectives.
- ConocoPhillips requests that the exclusivity provisions be amended to provide the state with more options. The treble damages clause is a significant issue that ties the state's ability to discuss resource terms for any alternative project over the next decade. Allow the coordinator and the streamlined permitting to apply to any Alaska gas pipeline project just like in the federal legislation. There must be some benefits in the provisions over existing law or the administration wouldn't have provided them.
- Finally, ConocoPhillips wants to achieve a framework that promotes the development of the Alaska North Slope gas resources and that addresses the legitimate interests of all parties. This project is so difficult that all parties must be on the same team and be willing to compromise. No

party will work harder than ConocoPhillips to make this project a reality.

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SENATOR THERRIAULT asked if AGIA isn't trying to say that if a party has constructive and creative ideas, now's the time to step forward.

MS. KING said our suggested changes wouldn't preclude commercial parties from having conversations at anytime. ConocoPhillips sees concerns with the prescriptive bid requirements regardless of the partnering structure. She reiterated that movement from bid requirements to bid variables allows the legislature the discretion to approve or disapprove the administration's proposed licensee. The exclusivity provisions are problematic. The licensee may have a good plan, but if they stumble, the state will be tied up for 10 years. That's a concern with such a large and unpredictable project.

CHAIR HUGGINS said his thinking has come full circle and his current preference is to have a consortium. Some of the flags that have been raised ought to be addressed, he said. With regard to the pipeline coordinator job, it's incumbent upon this committee to make sure it's legal. If there are points that require clarification, I hope that we get those clarified to the benefit to the state at a minimum, he stated.

SENATOR THERRIAULT said he has questions regarding the issue of the rolled-in rates and if the state would be the ultimate victim. He asked if AGIA allows the state to go to FERC and argue against a rolled-in rate if it is disadvantageous to the state. Perhaps AGIA can be structured so that companies wanting to bid for capacity have to agree to the rolled-in rate unless released by the state. He said he would explore the structure of a release mechanism with the administration.

MS. KING asked the committee to consider converting the bid requirements to bid variables and closing the exclusivity provisions.

There being nothing further to come before the committee, Chair French adjourned the meeting at [5:26:44 PM](#).