

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 9, 2007

3:31 p.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Bert Stedman, Vice Chair
Senator Lyda Green
Senator Gary Stevens
Senator Bill Wielechowski
Senator Thomas Wagoner

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Joe Thomas

COMMITTEE CALENDAR

Presentations by upstream shareholders

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

JOE MARUSHACK, Vice President
Gas Development
ConocoPhillips

POSITION STATEMENT: Presented update on gasline development.

MARTIN MASSEY, Joint Interest Manager
U.S. Operations ExxonMobil Production
Houston TX

POSITION STATEMENT: Presented update on gasline development.

MARK NELSON, Commercial Negotiator
ExxonMobil

POSITION STATEMENT: Presented update on gasline development.

ANGUS WALKER, Commercial Vice President

BP Alaska

POSITION STATEMENT: Presented update on gasline development.

DAVE VAN TUYL, Manager

Gas Commercialization

BP Alaska

POSITION STATEMENT: Presented update on gasline development.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [3:31:55 PM](#). Present at the call to order were Senators Wagoner, Stedman, Stevens, Wielechowski, and Huggins. Senator Green joined the committee at 3:33.

Presentations by Upstream Stakeholders:

JOE MARUSHACK, Vice President, ConocoPhillips, said that moving the pipeline project forward is critical. He said he might be freer to tell him what he thinks today, because he will be moving on to take the lead in ConocoPhillips' Australian unit in the next month or two. He said he has met in front of committees like this many times over the last six years and it has been a unique experience. He said he would address the issues that he thinks are really important in moving forward saying, "I truly believe, now more than ever, we are at a critical time in moving this project forward."

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SENATOR GREEN joined the committee.

CHAIR HUGGINS said he wanted speakers to keep in mind three main items that FERC said are milestones attributed to producers as critical items in the past - physical certainty for the State of Alaska tax and royalty provisions, certain jurisdictional permitting and financing issues and regulatory action in U.S. and Canada, and reasonable assurance over time that the project is economically feasible.

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MR. MARUSHACK said he would address number one and three, but he disagreed on the permitting issue. He said he has worked on this project for six years and in the past he has felt the "window of opportunity" wasn't necessarily critical, because he always recognized that there is a natural decline of the U.S. and Canadian resource base and therefore, this project could fit in

with a ten-year time line between starting the project and first gas. However, he said:

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Things changed about two years ago and I would not advocate that we have any absolute train wreck on our hands, but I will tell you this in my personal belief, we have gone from being in front of the curve to being in back of the curve right now and I'll tell you exactly why that is.

There is growing competition not only of gas on gas, but of all the other energy sources that are out there. In particular, we've got coal-fired plants being permitted right now in Texas and in places that historically haven't been permitted. And that's a legitimate loss of market for us. Coal is much like our gas pipeline. When we get this gas pipeline going, we'll flow that gas and it'll flow from then on for the next 30 - 50 years, whatever it is. It will not be interrupted. Coal-fired plants are almost the same way. Once you start up a coal-fired plant, you probably don't go back to gas or anything else. And we are seeing clean coal-fired technology now that has the ability to take some of our market. In addition to that, you are aware there is LNG competition out there; there's lots of gas in parts of the world, a lot of it wants to come into this country.

We also face the dilemma not only of other energy sources, but of massive competition for critical components. By critical components, I mean steel, machinery, labor, technical engineering and project management. Again, over the last period of time where we've seen prices really rise, we've seen projects move in front of us. And so we are back in the queue on getting steel and getting this equipment right now. That's a real threat to us, especially given we haven't announced this gas making its way to the Lower 48 and we still have a 9 - 10 year period in front of us before that gas, once we make that announcement.

I believe that the market needs to know the Alaska gas is coming and I believe they need to know it's coming fairly quickly. This is a very complicated project and if we had unanimous support at this particular time, we could move this project forward.

I won't talk too much about the historic contract that was put in place last year. We never really had time to fix the issues that you had out there, but had we, this project could be moving forward. We would be hiring Alaskans and moving it forward today as we speak.

We're now going to go into a new process. And that new process is going to take a little bit of time. And I'll give you an example of why I feel that way. When we bring a new member onto our team, we bring experienced people. We don't bring brand new people out of college onto this gas pipeline team. We bring people anywhere from 10 - 15 years experience who have done projects all over the world, who have unique attributes that make them important to this project.

It takes our team members about a year in order to be productive. And you might ask the other companies about that, too - but - there are certain things they can do, but the project is so complicated and it's so massive that to really become productive, it takes about a year to understand this project. So, I think it's going to take a new legislature and a new administration a certain period of time to really get comfortable with the issues and be able to move it forward, too. So, we have to move forward together; we have to move forward quickly; we have to avoid rhetoric and at all costs, we have to avoid litigation. If we're into a protracted litigation for any reason, I fail to see how we can move this project forward in the window that we've got.

The second point I want to leave with you is ConocoPhillips is absolutely standing ready to move this project forward. Now, we believe every company has a core skill and they'll all tell you what their core skills are, but one of our core skills is we pride ourselves on being problems solvers. We don't get rewarded; we don't get the opportunity to do other projects if we sit on issues. We get rewarded and we are motivated to make things happen. We want to work with you as the legislature; we want to work with Governor Palin; we want to move this thing forward now as quickly as we can.

I think our track record is pretty good in this regard. It's early in the life-cycle of this particular project, but we have to be ready to roll up our sleeves and work out those issues. Actually, I have some sympathy for a lot of what I've heard from various individuals including a statement from the Governor that she recently made in her state of the state speech in Alaska, which was that there's a lot of talk, talk, talk, and when do you stop talking and when do you start doing things. And actually I get frustrated with that, too, but the point is even though that's an accurate statement, this is a complicated project; it takes a long time to get up to speed on it. It's very difficult - I couldn't dictate the requirements that are going to be necessary to move this to you and it would be very difficult to dictate the requirements on the shipping commitments to me. We've got to move this thing forward and work it together.

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The next point I'd like to leave you with is a really really important issue which - I'm just going to digress and talk about the old contract just for one or two sentences then I won't hit it again - but the old contract was viewed as not a commitment to build a pipeline and was centered exclusively around the producers. And there's a reason for that. That old contract addressed the resource issues. If we can address the resource issue, the pipeline falls out of that. And I'll explain why that is. The resource issue is really the critical part of the equation here. The resource pays for everything through the shipping commitment. It's the most critical understanding in moving this project forward. Basically, even though this is a pipeline that will provide access to other explorers, what we know now and one of the real advantages we've got is we've got the ability to make long-term shipping commitments if we can get the deal right based on the balance sheets and the resources of the three major North Slope producers and actually the State of Alaska is in there, too. But those producers and the State of Alaska basically are going to pay for this project.

What we'll say when we say we making those shipping commitments is we'll deliver the gas to the pipeline,

we'll commit to deliver the gas to the pipeline. We'll pay the tariff - pretty much whatever it is under certain circumstances. If the tariff is worth more than the value of gas, like it could very well be and likely would have been back in September of this year, we will still make that gas flow, we will still pay that tariff - even if we're under water. We'll guarantee those shipping commitments for the term offered - most likely that's 20 years or more and if the cost of the project is more than expected, under certain circumstances, we will take that risk. Alaska is on the hook for that as well. If the project cost blows up, your tax revenue is less, your royalty is less, the impact to your Permanent Fund is less. Same thing happens if the gas price goes down. You're in the same exact position as we are. So, together we share a huge amount of risk on this project and that's really another reason why I believe we should be aligned in moving it forward. But in any regard, once the pipeline project is committed, Alaska and producers are at risk of any combination of events and once we've made that decision, it's irreversible.

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The pipeline, on the other hand, as opposed to the resource - or the pipeline owners - however you want to look at that, receives a regulated rate of return based on their equity contribution. If the cost of the project gets higher, they transfer that onto the shippers, they transfer that [indisc.] to the resource owners. So it's actually us again that pay for that. If the market goes south again, the pipeline really doesn't care about that because they receive a rate of return off the shipping commitment and off that tariff. So, prices go up; prices go down; we have the impact. If costs go up, we have the impact of that.

The only time the pipeline company is really at any risk for those dollars is between when the project's planning starts and when a successful open season is met. Those costs in there are probably anywhere between \$400 million - probably if you get to project sanction around \$1 billion or something like that. But that's really the only time on this \$20 billion or \$30 billion project, or maybe more, that a pipeline company really has any money at risk.

It's actually a little bit ironic that when you think about the pipeline company, they really have fiscal stability - because anything that happens - not anything, but almost anything that happens on taxes, they can pass on to the resource owners and the shippers.

The last point I'll make on this I'll make is if your - you know, this is a huge project in terms of the cost - whatever it is - \$20 billion, \$30 billion, \$40 billion - but given that, the only time that the pipeline has any real risk in this project is up front - and that's comparatively really small. If you can't fund that upfront cost by yourself, then this project really isn't for you.

So, I believe that if we address the resource issues in some form or fashion, we can get a deal done, but it's got to work for the state and it's got to work for the producers. That's the critical item. Those issues really involve what kind of agreement we can reach to address how the producers will be taxed and the terms around royalty and to the degree at which the state will work with the producers, so the producers can make this massive shipping commitment and be relatively certain that any potential value and upside is simply not going to be taxed away over time.

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You know, very simply put at least under the proposal we made last summer, the producers will take a lot of the risks inherent in a major mega project, but we ask your understanding and your help in addressing issues that are really under your control.

MR. MARUSHACK said he talked to the commissioners of the Department of Natural Resources (DNR) and Department of Revenue (DOR) about the new proposal. He hadn't heard any details. He has met with them twice and had good dialogue both times. The first time the commissioners explained what they thought the new proposal was. The second time BP went through some issues and ideas they had on the issue. He suggested that there were a few things that would merit a thought process behind them. The idea of splitting the pipeline issues from the resource issues has some merit. That separates the confusion somewhat. The pipeline issue is very simple, but the resource issues are very complicated.

Also the idea of looking at different pipeline proposals makes some sense to the state. However, he thought the fundamental issue remains - you have to address the resource side of the equation. "If you're successful on the resource side, the pipeline will fall out of that."

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MR. MARUSHACK related that his personal frustration was managing expectations and misunderstandings while retaining focus. He said:

Sometimes it really appears to me that what people think we're talking about is a parking garage. And we build parking garages all over the place, so we simply scale it up and now we've got a big parking garage. It's not that much more complicated than that.

But actually, this is nothing like Lower 48 pipelines. This is a major infrastructure project - on scale with anything in the world. And as such, there are really no models for this project. It's unique; it's got a myriad of complexities and there are very few simplifications that you can make in this project. But the most important thing on this project is to get it moving right now. And why I'm really saying that is a project like this, you get into an endless series of do-loops on what ifs and if you ever start down that path - and I have a little experience on a few projects where folks what if, what if, what if, what if - you can never get to the finish line on those projects. Basically, you've got to take a long-term look and focus on what's the most critical issue and the most critical issue is getting started on the project right now. And if you do that, and if we can build this project, then everything else gets better, if you will.

If we want a spur line at South Central [Alaska] that spur line is a lot more economic if it's built off of this major economy-of-scale main pipeline project. If you want to take liquids off, again, you're a lot better off taking liquids off of an economic massive project than any other concept that I can think of.

Jobs - the more economic the project, the more jobs that will be created. If it's an uneconomic project, a

sub-economic project, it will not support the growth in jobs in the state.

Exploration and access - we don't explore for gas right now. If we had this project coming, we would be exploring for gas and that's a whole new massive industry for the State of Alaska.

And then state economic growth - it's really in our interest as well as your interest that this project be successful and it spins off substantial revenues to the state - because we need additional sources of revenue in here and this gas pipeline project should provide that.

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Now really, we tend to get sometimes mixed up in emotion and I think the producers sometimes have that issue as bad as other folks. I'll give you a couple of examples on things that are basically rhetoric that has to really stop in order to move this project forward and starting to understand and work with each other. And a couple of them are probably some things like fiscal certainty. I suspect when producers say fiscal certainty, some people think that's attack on sovereignty. It's really not, but some people think it is.

Now from our side, we've got these problems, too. When folks say rolled-in rate, I can tell you we think that's code for subsidizing other companies. Neither of those are probably legitimate and both of them have to be addressed, but it's just examples of areas that we've got to work our way through and not get caught up in that rhetoric. I honestly believe ConocoPhillips and the State are aligned in wanting to have the best project move forward. We want revenues for the state, we want revenues for our self, we want an exploration business here; we want to grow this business. We think we have a lot of insight into this area and probably some competitive advantages and we want this project to happen.

Another series of issues really - I'll focus on this rhetoric issue a little bit. It's really damaging; it causes us to lose some focus - is there's a misunderstanding that this project is wildly economic,

obviously economic. And I'll give you a couple of examples why nobody can really say that. The first is dealing with cost. Now in 2001, we put \$125 million into this project, didn't weld a piece of steel and we basically had a cost estimate at the time of \$20 billion. Since then, steel prices have doubled, labor has gone way up, the queue for equipment has drastically changed, project management skills are much more difficult to find and the bottom line is nobody - not us, not anybody else - can tell you exactly what their projects costs are until they rebuild all that engineering work. Now I can tell you it's not \$20 billion anymore. It's north of \$25 billion, I would guess. But nobody can really tell you to what extent how high that is. So that's the cost side of the equation and you're only going to know that when we invest another \$100 million or so in order to get that.

The other equation is the market. And the market is \$10 last year and it's below \$4 last year. It's all over the place and it's hugely volatile. And if you look at the long-term, the forward curves, if you will, sometimes they can be above \$10, sometimes they are below \$8, the bottom line is nobody really knows what prices are going to be. All we can really do is get the most economic project that we possibly can. We've got to get our deal done; we've got to put Alaskans to work, we've got to move this project forward and we'll find over time if we can get to that project sanction and move this project forward.

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So, I'll conclude my prepared remarks, if you will, by leaving you just four key items. One, ConocoPhillips is ready to solve issues with you and the Governor. We think we're pretty good at it; we think we're reasonable; we think there's a historic basis for us to make those statements, but we need the legislature and the administration to actively engage with us. I don't see any way we can move this forward if we're not actively engaging together.

The key to addressing the pipeline is really to address the resource issues. We've got to provide adequate security to the companies in the areas where the state can so that those shipping commitments can

be made, because they are the critical component in making this project happen. Although the pipeline will serve a lot of parties, the bottom line is that it's really the three major producers, as well as the state, that are on the hook for this pipeline project.

Time is important and though we don't need to rush into a bad deal, we need to be telling the market our gas is coming. This project is difficult; it's complicated; we've got to be on the same team. I think it's going to be extremely difficult to move this project forward unless the entire state of Alaska and the producers are all on the same page trying to move this forward. We've got to stay laser-focused on getting this project moving forward together. And I'll leave my conclude remarks by just telling you that I'm personally committed to this project still and even after I leave this area, I'm going to be watching this like hawk doing everything I possibly can to help move this project forward. ConocoPhillips is committed and I appreciate the opportunity for you to listen to my thoughts.

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SENATOR WAGONER asked the average price of gas overall last year.

MR. MARUSHACK guessed north of \$8 and he offered to get the correct information for him.

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SENATOR WIELECHOWSKI asked if one of the producers wanted to take its share of Prudhoe Bay gas and participate in an open season and the others were not interested, would ConocoPhillips agree to that.

MR. MARUSHACK answered that there are probably ways of doing that, but then the gas balancing issues at Prudhoe Bay would have to be looked at - how would that affect the other producers, how does that affect oil production and pressure maintenance. It's not a simple question. It's been thought about a little bit, but there are no firm answers.

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SENATOR STEDMAN said he didn't look forward to having a project and an open season when no one shows up and he asked who he thought would show up.

MR. MARUSHACK replied the first thing you have to have is some sort of agreement on taxes with the state that will allow long-term shipping commitments. He likened a long-term shipping agreement to owning a house.

We're going to live in the house forever. We're going to pay for the house no matter what, but we've got to know that we're going to have the wherewithal to pay for that house and to actually make some profits when we do that. So, I believe we've got to have a deal around the fiscal terms that will allow those shipping commitments to happen.

Now, there's another issue out there, too, Senator, and that is the issue of cost overruns. Now I can tell you with pretty great certainty that if the producers - let me just talk ConocoPhillips and not the producers - if we're managing that project, we have an ownership in that pipeline, we'll take the cost overrun risk. We do it over the world; we'll do it on this one, too. But - and the reason for that is because we have a process that we think has the best opportunity of keeping that cost as low - it's not that we don't have overruns, it's that if we have the problem ourselves, we'll pay for it ourselves. I think it's going to be more difficult, however, if it's somebody else that wants to build that because they wouldn't have the same interest in making absolutely guaranteed that it's the lowest cost project and have the same sort of processes. And again it gets into this disconnect where if you don't own the resource and yet you are going to be held whole on the pipeline itself, there's less interest in making absolutely sure that the cost is as low as possible. I wouldn't say impossible and there may be ways around it, but I do think it's an issue that the producers are very interested in managing that cost and that means matching up throughput with ownership for the most part. I think those are probably the two big items that I can think of off the top of my head that are probably the most critical items in making sure we don't have a train wreck when we have that open season. Believe me, an open season process where nobody shows would be a terrible thing for the state; it would not be good thing for the producers.

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And this really gets into what happens in that case. One this is for sure; we've lost a lot of time, we've sent a terrible signal to the market, we may end up in some sort of litigation, which adds more delay onto that and so, I think this has to be avoided at all costs. The way to do that is to get our deal done on the resource side and then we've got to figure out if - again I think it's probably best - if we're aligned on the pipeline and the resource and shipping commitments.

4:00:04 PM

SENATOR STEDMAN said it appears that the new contract is going to be vastly different than the old one. Clearly gas in-kind was an issue. He asked if shared ownership of the pipeline with the state would be problematic rather than the alignment that was in the old contract - using 20 percent gas in-kind.

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MR. MARUSHACK replied that the old contract for the most part was whatever you ship, you own. He thought ConocoPhillips could find a way of working around the state not wanting to take a shipping commitment. The shipping commitment would have to be addressed somehow.

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MR. MARUSHACK related that he just had his board to talk issues over with and they have all been in his position at the table, but he realizes the state has a board of 600,000 people who haven't sat across the table. "That's something that we've got to be cognizant of and help you with, too, because the way you've got to sell your side of the deal is probably much more difficult than the way I have to sell my side."

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SENATOR WAGONER asked for a scenario on cost overruns and how those would affect the tariff.

MR. MARUSHACK replied with what he said was not an accurate example. He started with a \$25 billion project. He assumed that would make an average toll of about \$3 mcf/20 years. The producers all sign up for that deal and a problem comes up and the cost is \$50 billion by the time they are done. If that happened, one might expect the toll to go from \$3 to \$6. The producers are still on the hook for that.

And so, here's what happens. If gas prices are \$8 and the toll is \$6, we've got \$20 to do all our development work and whatever else we need to do. Maybe it makes some profit, maybe it doesn't. If it's \$5, or if it's \$4, we ship that gas. We pay the toll; and we sell the gas at a loss. So, that's the cruel reality. This is why it's so important to the producers that they have some management of that project. The other thing is, too, if you're going to live in the house and you're going to pay for the house, how many of you don't own your house? Nobody probably - and so that's another reason you don't want to pay a rate of return to somebody when you could pay it yourself if basically you're going to live in the house and own it your whole life.

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CHAIR HUGGINS mentioned if the existing PPT would be about right going into this process.

MR. MARUSHACK replied no, in the last contract the state took 7.25 percent of the gross. "It wasn't a net calculation at all." His personal view on PPT is that it would not result in what the state wants - which is more investment on the oil side long-term. Alaska has a fairly steep decline and if it doesn't get enough investment, it will be even worse. It represents a substantial increase on taxes on oil, which affects investment long-term and under the current PPT, if that is transferred to gas, that is a big problem.

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CHAIR HUGGINS asked him if he had any showstoppers to bring before the committee that he hadn't touched on before he leaves.

MR. MARUSHACK replied he could figure out how to give the state almost anything it needs if it would be willing to give him something else in return. That means huge amounts of tradeoffs and a lot of understanding.

I would say this. If they aren't showstoppers, they're pretty close - one of which is we have to address the resource issues. There's no way around addressing the resource issues. It's too big a project; it's too big a risk on the part of the producers. It has to be done. Another one is...no public company is going to subsidize another public company. So to the extent that there's any issues out there that might be viewed

as that, we've got to find a way to work around that. That doesn't necessarily mean that I'm telling you anything does or doesn't work. But I'm telling you a showstopper would be you're not going to get any company to subsidize another company.

The third one is not a showstopper, but it's a serious issue. I personally have trouble figuring out how you make that shipping commitment if you don't control the cost and so I think those three things are extremely important issues for us. But again, you know, almost anything else, if you say you really need something, I'll bet I can figure out a way to - or my team and BP and Exxon could figure out a way to get it for you. It's just a matter of what the offset is to that, sir.

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CHAIR HUGGINS asked what he would say to the Governor about the new process.

MR. MARUSHACK replied that everyone deserves the benefit of a doubt until they see what comes out.

We are here to do a deal. We're here to work with the administration. When I say that, I actually believe it's going to take a huge amount of negotiations. I remember when we first started this with the prior administration. Will Condon was on the other side and we were talking, talking, talking. We thought we were negotiating. We are not negotiating until we're working 16 hours a day, seven days a week and working late at nights. I've never done a deal yet that wasn't full-time, painful lots of time and effort, on these big projects. So, I would voice let's get to the table; lets start working these issues. Let's focus on the resource issues because the pipeline will actually fall out as a result of that....If people are flexible, we can get to the finish line on it.

CHAIR HUGGINS asked him to estimate when he thought the state would get to the point of shipping gas.

MR. MARUSHACK replied that once they have a resource deal that meets the state's and the producer's needs, 9 - 10 years from first gas at signing. That's assuming they can get the materials they need. He didn't know what it would take to get to that

point. He said that it took Wendy King a year to get up to speed on this and it will take the new people at least that.

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SENATOR WAGONER pointed out that the PPT is at 22.5 percent and the contract was negotiated at 7.5 percent - gross versus net.

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CHAIR HUGGINS announced that ExxonMobil's presentation would come next and that Mark Nelson, Commercial Negotiator for ExxonMobil was at the table.

MARTY MASSEY, Joint Interest Manager for U.S. Operations for ExxonMobil Production testified via teleconference and said he is responsible for commercialization of ExxonMobil's gas resource in Alaska and has had this position since 2001; Mr. Nelson had been working in Alaska with him for the last several years. He said that ExxonMobil is committed to advancing the Alaska gas pipeline forward and are ready to work with the legislature and Governor Palin and her cabinet. This project has the potential to add over 1 bcf/day of gas to ExxonMobil, which is more than their current daily gas production; it can also add over 1 billion oil equivalent of crude reserves. That is nearly enough to replace a full year of its production.

Given the significant impact this project can have on our business, we are obviously very interested in progressing it so we start getting revenue from this important resource. We've spent a lot of money over the years, \$180 million or so, studying ways to commercialize Alaska gas and since the 1970s we have evaluated LNG, we've looked at gas to liquids and we've looked at gas pipelines. Based on these studies, we've determined that a producer gas pipeline project will result in the best value for the state, the producers and the nation. It is a bit disappointing having been so involved in the last effort, you know that we didn't get it done, because we could be getting ready to get out in the field to gather information necessary to finalize the design and conduct an open season.

MR. MASSEY recognized that public comments have to be addressed to the satisfaction of the state and the producers and ExxonMobil is ready to do that. The Governor is considering an RFP process and he has met with her on several occasions and hoped for a successful result.

MR. MASSEY agreed that the scope of the project and the risks that come with it are not well-understood saying, "The project is a world-scale undertaking with significant risks. It will be the largest private investment in North America...."

He said many factors impact commercial viability like the costs that are going up on materials and labor. The estimate in 2001 was \$20 billion. In addition, inflation and a number of other mega projects are going on in the world. Gas prices remain very volatile. Other risks have been mentioned like cost overruns, schedule delays, construction conditions, regulatory and state fiscal uncertainties.

With size comes complexity, Mr. Massey said, and then it's even more important to get the design concept right - the contracting and marketing plans and executing them well. With size come the consequences of poor execution. He said a limited number of companies have demonstrated the capabilities and financial strength to effectively participate and manage this world-scale mega project. "The producers - ExxonMobil, BP and ConocoPhillips - are strongly represented as project developers in these sorts of projects worldwide and have demonstrated success in meeting the project deadlines."

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MR. MASSEY said it was important to recognize that the federal government has also addressed risks associated with this project and has established a federal pipeline coordinator office. Producers have the maximum incentive to control the costs; low capital and operating costs will result in a lower toll and that will result in a higher netback value for the gas. Also the project they envision will go into a premium gas market. And the state receives the majority of the revenue from the value of the gas. There is no such incentive for third-party owners who benefit from increased capital costs. The producers also have the necessary project and operating experience.

You know, this is a basin-opening project and with any basin-opening project, it requires alignment between the host government and the leaseholders. The producers and the state both want to develop ANS gas and open the basin to gas exploration. Also obviously, Alaskans are going to be key to the project execution. Both the state and us want Alaskans to benefit, you know, for the job opportunities.

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MR. MASSEY went on to explain how pipelines are financed and who bears the risk. Commercially sound oil and gas pipeline projects traditionally have been financible if they have a couple things: one is strong sponsors with proven track records and the financial strength to backstop commitments. The producers have this financial strength. The commitments will take the form of firm transportation agreements. He said that to provide funding, any financial institution will require firm long-term shipper pay contracts; those have to be provided by credit worthy parties.

I think that Joe said it very well that when we sign up those transportation commitments, we will pay whether the gas flows and whether or not what the price is. These firm transportation commitments are needed for pipeline investors to show the creditor that it has the capacity confirmed over sufficient duration to secure the financing. Pipeline owners rely on the financial strength of shippers to secure that project financing and it's also required to obtain a first certificate.

The shippers provide the underpinning for this financing and the risk will be passed back to them in the form of committed tariffs. The producers have the financial strength to backstop the commitments that we talk about, but the producers cannot make the firm commitments unless they're confident the gas pipeline project can be built and operated on a long-term commercially viable basis including being competitive with other sources of supply.

If you think through that, it only makes sense that the parties taking the risks need to be able to manage those risks - especially on something that has the scope of this project.

[4:23:19 PM](#)

MR. MASSEY said ExxonMobil is committed and ready to move the project forward.

[4:23:36 PM](#)

SENATOR WAGONER said it looks like they were starting all over again, but he hoped not. Last year, Mr. Massey stated that ExxonMobil may or may not elect to continue ownership of the pipeline after construction is done and gas is being shipped. He

asked since FERC sets the rate, and if ExxonMobil has an overrun of \$5 billion for a \$25 billion project, would the rate for shipping be figured on the \$25 billion or, if line is sold to an independent pipeline company, would ExxonMobil ask FERC for an adjustment to the tariff to include its total purchase price of the project and therefore, roll in the \$5 billion. Mr. Marushack figured the shipping would be figured on the \$25 billion.

MR. MASSEY replied:

I believe the way that process would work is that when we sign the firm transportation commitment, the deal is basically done at that point in time and we will be committed to pay that tariff within some constraints, no matter what it costs. And that tariff is pretty well locked in through that firm transportation commitment and FERC will basically bless that when the pipeline is completed, you know, from construction. That's what you would be selling, if you sold it - is you know the pipeline asset - and you know the commitment that someone has given to the pipeline for the firm transportation. You know, we've said before and I think you're exactly right that a lot of the risk associated with this is upfront when you're in the construction period and trying to get this project started. You still have the ongoing risk after that of the fact that you've made that firm transportation commitment and it will probably still be difficult to sell the project, you know, while you're in that firm transportation commitment mode. But, you know, that first 15 - 20 years, but that doesn't mean it can't happen and it has happened in other places. I hope that answers your question.

SENATOR WAGONER asked if an independent pipeline company would want to pay more than \$25 billion for it.

MR. MASSEY replied probably not:

It really gets down to a commercial deal at that point in terms of what somebody is willing to pay for your interest and what they're going to get is, you know, the deal that's been cut and has been blessed by FERC.

SENATOR WAGONER responded, "All I'm saying is it'll lower their rate of return if they paid the higher figure, because the price is set by FERC and it isn't going to change."

MR. MASSEY responded, "That's right."

[4:27:03 PM](#)

SENATOR STEDMAN asked how he defined alignment and non-alignment.

MR. MASSEY replied that alignment can take on many things; but this project is so complex that it can't get started unless the state and the producers are all on the same page.

If we're at odds with one another, we're not going to be successful. It doesn't stop with just the deal. We have to work together on how do we permit the thing, how do we put the other necessary things in place.... The project is just too big, too risky for anyone to try to do that without having that alignment. If you look back to the past deal - and I'll try not to talk about the past deal - but we were aligned in that we both had an ownership position in the project. With that becomes - that kind of motivates you. We had to put money into the deal and all of us had to put money into it together. It motivates the parties to make it happen. And that was one of the benefits associated with that. That doesn't mean that has to be there, but the concept has proven successful in many projects around the world - for the host government, if you will, to take an ownership in a big project like this.

[4:29:06 PM](#)

SENATOR STEDMAN asked what risks a third-party pipeline builder would face.

MR. MASSEY replied that the risk is upfront for them and how much capital they are really willing to invest - such that during the open season, someone will really be there to make a commitment to their project. Once they have that commitment, because it's a regulated activity, they are guaranteed a return.

I think that's why you'll find as you go forward here that there will be very few companies that are willing to put a lot of money up front at risk associated with this project, especially until they get this firm transportation commitment.

[4:30:21 PM](#)

SENATOR WIELECHOWSKI asked if ExxonMobil was not taking its gas out, would it allow the state to take its royalty share in-kind to participate in an open season.

MR. MASSEY replied that is a good question, but he had not looked at it in terms of what the agreements would allow.

I've not really addressed that because we've hinted to work together to try to move this with all the parties. It is difficult to see a smaller project without the economies of scale being commercially viable, but that doesn't say, based on different parties needs and so forth, and what they're trying to achieve that it couldn't happen. And I'll just have to tell you, we will have to go look at that. We have not.

SENATOR WIELECHOWSKI asked if one of the producers wanted to take its share of Prudhoe Bay gas and participate in an open season and the others were not interested, would ExxonMobil agree.

MR. MASSEY replied:

The three of us have said that a project of this magnitude takes all three of us including the state. We're all major working interest owners in Prudhoe and Pt. Thomson and Prudhoe is going to be the major field that backs this thing and it really is going to take all three of us. So, we just really haven't dealt with that issue.

CHAIR HUGGINS indicated there were no further questions and thanked Mr. Massey and Mr. Nelson for their remarks.

[4:32:24 PM](#)

ANGUS WALKER, Commercial Vice President, BP Alaska, and DAVID VAN TUYL, Manager, Gas Commercialization, BP Alaska, introduced themselves.

MR. WALKER said that because of the newness of his role, Mr. Van Tuyl would provide the bulk of BP's briefing. However, he reiterated that BP is 100 percent committed to moving the Alaska gas pipeline project forward. It's a very important project for both BP and Alaska. He said, "It is clearly something that is vital to extending the life of the North Slope and economic life

of Alaska, itself," and to do it properly they must work together closely.

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MR. VAN TUYL emphasized that BP is ready to go forward and ready to work with the state on this project. It represents the largest known undeveloped resource in BP's portfolio and he said, "We would very much like to remove that distinction of this Alaska gas resource." He said the gas project is important on its own, but it also extends the economic life of light oil production from the North Slope as well as open other opportunities. He stated:

BP stands ready to work with the new administration and the legislature to reach a balanced fiscal framework that works for all the parties. Finally, that successful agreement with the state is going to set a stable foundation for a healthy viable oil and gas business for decades to come.

He said that BP has a long history in Alaska and has been actively involved in exploring for, developing and producing Alaska's North Slope energy resources for decades and, "We have the opportunity for a bright future ahead, as Angus said. In fact, we envision a 50-year future in Alaska." With that, he showed the committee a graph of BP's production through time. He emphasized a few key points - that production is declining was one - even with significant new investment. The decline in production can be made up with some new opportunities - from heavy oil resources and gas. However, the future is not a given, but it is what is possible and that, "That future is only made possible with an Alaska gas pipeline project."

MR. VAN TUYL said the gas pipeline would give BP the opportunity to extend the life of its economic oil production into the future. It opens up the opportunity to unlock the heavy oil resource that's on the Slope and creates a new gas industry in Alaska. It creates a new source of revenue for resource owners - including the state.

The gasline gives them the opportunity to extend the life of the basin.

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The next slide showed what Mr. Van Tuyl called cornerstone concepts. Any project contains three basic kinds of risks: price

risk of what the product will actually get in the marketplace, the cost of development, and fiscal and regulatory risk.

He explained that the price is set by markets, which remain volatile and that the producers are price takers, not price makers, just like the state. The project costs have also risen. As energy prices have increased over the last few years, the costs of bringing that energy to market have also risen dramatically. Steel prices have doubled, costs for labor, fabrication, engineering, permitting and buying equipment have also increased significantly. This presents a major challenge for any mega-project. But remember, Mr. Van Tuyl said:

The Alaska gas pipeline project is not any mega-project....Because of its size, it's really in a class of its own. It's potentially the largest privately funded infrastructure project ever. We need to bear in mind because of that a sobering fact is that most mega-projects exceed their sanctioned cost estimates. So, while gas prices have generally increased over the past couple of years, so have project costs. And the net result is that the project remains challenged.

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And finally, as we said, there's fiscal risk associated with any project. So, we have these risks. How are these risks best managed? Price risk is inherent to any commodity like energy. It's borne by the resource owners. It's a risk that producers here in the state take. It's what we're in the business of taking. Cost risks on mega-projects is something that companies like my company, BP, ExxonMobil, ConocoPhillips are well acquainted with managing through rigorous project management processes. And as fellow resource owners along with the state, we think that careful management of costs is absolutely critical in maximizing the value of the resource. That's really the benefit of this project - is getting the - maximizing the value of Alaska's gas resource. The people that hold that risk, the cost risk, need to be able to manage that risk. They're the ones most incentivized to manage that risk.

Finally, fiscal risk - fiscal risk is mitigated, simply put, by an investor knowing the rules. That's what reduces the investment risk. The state can work with investors to minimize that risk. So, we've mapped

out before us what we think is an amazing opportunity, but one that comes with significant risks. Therefore, we need to get the risk and reward balance right.

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MR. VAN TUYL said he thinks the state is uniquely positioned to help overcome these challenges through an open process.

We think it should be open with the same rules for all the parties. That would allow the best project to move ahead. One of the things we think is really important is allowing the free market to work. That's when the best ideas are created. Certainly a project like this needs good ideas to allow that best project to emerge. We think the process should take advantage of some common goals that we have. One is that we're all ready to see a gas pipeline project advance. Another is that we think the process needs to have legislative and public support and also we think again that the resulting project has to maximize the value of Alaska's resources. I can't say that enough.

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MR. VAN TUYL closed with another look into the future.

The future that Angus and I spoke about at the open is right in front of us. It's captured the imagination of BP; it holds incredible opportunity for the state. We think it's the promise for future generations of Alaskans and it's available to us. As exciting as it is to talk about the future, we would much rather be rolling up our sleeves to begin work. We think that's made possible once we jointly define the rules that establish that risk/reward balance we talked about for the project. So to close, I'd like to emphasize again that BP standing ready, willing and able to work to this future in an open process with the state and the legislature as we described, that allows for a timely resolution so that we can actually get about getting started with the project. And with that, I'll conclude and thank you again for the opportunity to testify and I'd be happy to answer any questions that you might have.

[4:46:23 PM](#)

SENATOR WIELECHOWSKI asked how much in federal loan guarantees this project has.

MR. VAN TUYL replied that federal loan guarantees provide up to \$18 billion of the project capital.

SENATOR WIELECHOWSKI asked if any other project in the country has that amount of loan guarantees.

MR. VAN TUYL replied that he was aware of none.

SENATOR WIELECHOWSKI commented that they are talking about allowing the free markets to work, but there is significant government interplay with the \$18 billion guaranteed. "So, we're a little bit outside the free market, already."

SENATOR STEDMAN asked if the full faith and credit of BP would be on the line to access that credit guarantee.

MR. VAN TUYL replied:

Any federal guarantees are only available to the holders of a certificate of public convenience and necessity offered by the FERC and the National Energy Board in Canada. To hold that certificate, those companies would have needed to enter into these firm transportation arrangements which are backed by their basically a corporate guarantee. So the short answer to your question is yes.

SENATOR STEDMAN said:

Not to diminish the value of the loan guarantee, but if the three majors were to gather on a pipeline - one-third, one-third, one-third - to be accessed those loan guarantees, we'd pretty much have to liquidate the equity out of at least one of the companies and severely damage the other two.

MR. VAN TUYL replied:

The project itself will be backstopped by firm transportation commitments. The federal loan guarantees, if they're used, would enable the investors in the project, perhaps, to get a better financing rate on - bearing in mind that some of the companies here before you have some of the best balance sheets in the world and can already obtain pretty attractive financing - but the ultimate

backstop of those firm transportation commitments that underpin the project are guaranteed by those corporations. Those FT arrangements aren't backstopped by the federal government.

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SENATOR STEDMAN asked what the state could do to assure that people show up at an open season.

MR. VAN TUYL replied that it is in everyone's best interest to insure a successful open season.

A couple of key ingredients are that the service that's offered is a service that is responsible to the customers. What that means is we have a low cost project that is offered that encourages shippers to participate. We do that if we have confidence that we have these cost management practices that we have in place and that we have confidence that we can deliver a low cost project.

Cost management is one thing that's very important and the other is to insure that those folks that will be making those firm transportation agreements at the open season have confidence, again, that they know the rules. This is what both Joe and Marty talked about and the need to define the resource terms in advance of the open season. That reduces a huge risk for the resource owners who will be making that commitment and that would make that possible.

[4:51:23 PM](#)

SENATOR THOMAS said that Prudhoe is short on gas at this point and he asked what volume would be necessary to move the project forward.

MR. VAN TUYL replied that 51 tcf of gas would be needed for a project that would extend out 35 years. Prudhoe Bay has a known resource of 24 tcf; Pt. Thomson has a known resource of 8 tcf; and other places around the Slope add up to 34 - 35 tcf. All of that is needed, so more exploration is important. He was disappointed with the Pt Thomson situation and thought that people need to work together jointly to solve it.

[4:52:55 PM](#)

SENATOR THOMAS said that once that's established, what has been done to establish where the other 15 tcf of gas will come from.

MR. VAN TUYL replied that Mining and Minerals Service (MMS) and United States Geological Survey (USGS) studies indicate 100 - 200 tcf of additional gas. This project will create incentive to explore and find it.

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CHAIR HUGGINS said last year they went through an exhaustive process and multiple sessions and asked him what parameters may have changed from his corporate perspective that would come to bear in the new process.

MR. VAN TUYL agreed that last year he and his colleagues had gone through a rigorous process and projecting that forward, he didn't see necessary just one solution to all the problems that are before them. He said they stand ready to address the concerns that were raised last session. They are open to new ideas on how to get the risk and reward balance right.

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CHAIR HUGGINS said his constituents want a pipeline and he didn't want to test their patience. The legislature wants to work with all the parties to make this project work. The administration wants the same. He asked if any of the producers wanted to make any other comments.

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SENATOR WAGONER wanted MR. MARUSHACK to come back and talk about how difficult LNG siting is in Long Beach. "You know it's easy to get a FERC permit sometimes, but it's pretty darn hard sometimes to site an LNG facility." He explained that the reason he asked this is because there is a lot of angst among some of them about how LNG is going to flood the market and take the market away and there won't be an opportunity for a pipeline. "I think that's some scare tactics that some people are using and they're not necessarily true."

MR. MARUSHACK responded that hopefully ConocoPhillips wasn't using those tactics, but agreed that siting LNG facilities is tough on the Gulf Coast. A number of them have gone forward. Four facilities already exist. ConocoPhillips' facility in Maine was turned down by the locals and the one in Long Beach is difficult. However, he doesn't believe that LNG by itself is really the competition. It always goes to the coast and then the gas has to be pushed all the way across the country. The Alaska pipeline project goes to the middle of the country and out from there. He thought that was a real advantage over LNG with an

isolated market with a long ways to go to get it to other locations other than the Gulf Coast.

But the problem now is these other alternatives - coal and the real emphasis on alternate energies including ethanol and things like that. I see those and in fact, more importantly, the way I see it, Marianne Kah, our chief economist, has talked to you all and she sees this as a real issue and she has been clear, I think, with me and with members of the legislature that she believes we've got to move this thing forward real quick. The market must know - everyone knows it's going to happen - it's going to be 10 years from when we start, but the market must know this gas happens. Just by knowing that, 4 bcf/day is a huge volume. That will create opportunities for us if the market knows that's coming.

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CHAIR HUGGINS asked using the Gulf Coast, what the timeline is from concept to production for citing an LNG plant.

MR. MARUSHACK replied the real problem now is there is a huge backlog of LNG exchanger equipment, so you've got to be in line or else you've really got a long time line in front of you. Almost any major infrastructure project, you're talking about that 8 - 10 year time period. ConocoPhillips got its LNG facility in the Gulf Coast in 5 years from design, but that was only for the receiving terminal. That has to be matched up with where the resource is coming from.

CHAIR HUGGINS thanked everyone for their comments and adjourned the meeting at [5:02:05 PM](#).