

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 23, 2007

1:35 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

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

WITNESS REGISTER

MARTIN W. MASSEY, Manager
Joint Interest
ExxonMobil US

POSITION STATEMENT: Spoke in opposition to SB 104.

PAT GALVIN, Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding SB 104.

TOM IRWIN, Commissioner
Department of Natural Resources
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding SB 104.

MARK HANLEY, Manager of Public Affairs
Anadarko Petroleum
Anchorage, Alaska

POSITION STATEMENT: Spoke to SB 104.

DAVE VAN TUYL, Gas Commercialization Manager
BP-Alaska
Anchorage, Alaska

POSITION STATEMENT: Spoke to SB 104.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [1:35:07 PM](#). Senators Wielechowski, Huggins, Stevens, Wagoner, Stedman, and Green were present at the call to order.

SB 104-NATURAL GAS PIPELINE PROJECT

CHAIR HUGGINS announced the consideration of SB 104. He said the only company he has not heard from is Mid-America. There will be a joint session tomorrow for public testimony, he noted.

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MARTIN W. MASSEY, U.S. Joint Interest Manager, ExxonMobil, said he has held his position since 2001 and is responsible for ExxonMobil gas resources in Alaska. The company has been in Alaska for over 50 years and has been a key player in oil development in the state. It holds the largest working interest in Prudhoe Bay, and current net production is 150,000 barrels of oil per day. Commercializing the Alaska's North Slope gas will allow for the relationship with Alaska to last another 50 years or more. The project has the potential to generate billions of dollars for the state, the country, and for Canada. It could supply energy for Alaska and North America for decades to come. ExxonMobil supports efforts to advance the pipeline project and is ready to work with the state. ExxonMobil's share of gas in the pipeline has the potential to add over one bcf per day, which is more than a ten percent increase to its current worldwide gas production. ExxonMobil has spent more than \$180 million studying ways to commercialize this gas.

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MR. MASSEY said, based on studies, it has determined that a producer gasline project will result in the best value to the state, to the producers, and to the nation. ExxonMobil is committed to moving it forward. There is a perception that this is just a gas-treating, pipeline project, so there is a tendency to underestimate its size and risk. The pipeline would be the largest private investment in North America, significantly larger than most oil and gas mega projects. Nothing compares, thus many factors impact commercial viability, and the previous estimate of \$20 billion has grown because of steel prices and labor costs. Also, worldwide mega projects are placing pressure on pricing and availability of global materials. Despite recent increases, gas prices remain volatile. The price of natural gas before 2000 was less than estimates of gas transportation and treatment costs. He said other risks include cost overruns, schedule delays, and regulatory and state fiscal uncertainties. Investments will have to be made ten years before the gas flows down the pipe. Size accentuates the impacts of poor execution. A mistake made on this project would cost everyone dearly.

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MR. MASSEY said commercially sound oil, gas, and pipeline projects traditionally have been able to obtain financing with

strong sponsors. Key project commitments will take the form of firm long-term gas transportation commitments (FT), which are binding obligations made by the companies, known as shippers, to pay for the costs of receiving a quantity of gas capacity on a pipeline over a specified period of time, typically many years. The commitments are made during an open season, which will last at least 90 days during which any prospective gas shippers can make binding commitments for transportation capacity. Financial institutions require commitments to provide funding for a pipeline, and they must be provided by credit-worthy shippers. In this case the shippers will be the producers and, indirectly or directly, the state. The FTs are substantial and in the tens of billions of dollars, and they must be paid whether the gas is moved or not. The shipper must pay regardless of the price of gas. Pipeline investors use the FTs to show creditors they can secure financing and must rely on the financial strength of the companies backing the FTs to secure the financing. So the financial institution will look at who is making the FTs to decide if it is secure enough. Thus the development cost and overrun risk are ultimately borne by the shipper.

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MR. MASSEY said the shipper must make long-term FTs and agree to pay the transportation and treating rates that are based on the ultimate cost of the pipeline and treating facilities. The information will be a projection of the costs, which is based on the entity doing the work. So the parties taking the risk must be able to manage those risks. The producers, as shippers, cannot make FTs during open season unless they are confident the pipeline project can be built cost effectively and operated on a long-term commercially viable basis, including being competitive to other gas. Maximizing the value to the state requires selecting the right design and delivering gas at the lowest possible cost. A project this size means construction and operating experience should be a significant consideration. Only a limited number of companies have demonstrated the capability and financial strength to do it. The producers have such experience on numerous projects world-wide and have demonstrated success in meeting objectives. ExxonMobil operates on every continent except Antarctica. It is the world's largest non-government producer of both oil and natural gas. Its global development company is unique within the industry. It leads the industry in project costs and schedule performance. Costs have been 20 percent lower than the industry average on a dollar per barrel basis, and nearly 90 percent of ExxonMobil's projects with costs greater than \$1 billion are delivered within 15 percent of the estimated costs at the time of project funding,

and nearly 80 percent of those were delivered within 15 percent of the funding schedule. ExxonMobil's superior performance was validated by a report. It came out on top of the analysis with the lowest slippage rates despite taking on challenging projects. It is highly competent, he stated.

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MR. MASSEY said ExxonMobil has extensive Arctic experience. Its Arctic offshore activity started in 1966 with the installation of the ice-resistant platform in Cook Inlet, which is still producing oil. In the 1970s ExxonMobil provided research and engineering for Prudhoe Bay and developed the combined hydraulic flow model and thermal simulator for the design of TAPS. In 1984 ExxonMobil installed the concrete island drilling system in the Beaufort Sea. It has extensive experience in Canada. He named projects including the first and only iceberg-resistant offshore structure in the world. He spoke of an offshore platform in Russia. These examples show that large projects with significant complexity "is what we do." ExxonMobil has a long-term commitment to technology innovation, and that has played a key role in Alaska oil development. It spent \$3 billion on technology since 2002. ExxonMobil has demonstrated world-class leadership in safety and environmental performance. Its employee recordable incident rate is below the average U.S. petroleum industry benchmark. It's commitment to safety, health, and environment manifests itself in superior performance across all operations. The gas project is a basin-opening project that will benefit the state and industry. Such projects are successful when there is alignment between the host government and the lease holder. "At a high level, we are very well aligned." A producer-owned gasline project will result in the maximum value to the state and to them. The producers have the maximum incentive to control costs. Low capital operating costs and access to a premium market will result in a higher netback value on the gas. The state will receive a majority of its revenue from the gas sales via revenue received under the royalty settlement agreement and for the taxes that are paid.

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MR. MASSEY said third-party owners do not share the same incentives—they actually benefit from increase capital costs. He said both the state and the producers want Alaskans to benefit from future job opportunities. To progress the project and mitigate its inherent risks, ExxonMobil needs some things from the state. The billions in financial commitment require fiscal terms that are predictable. ExxonMobil is willing to take the geologic, cost, and commodity price risks, but it is not willing

to take a tax-change risk. Market risk is inevitable, but it is managed by getting the products to the best market. Fiscal risk is outside of ExxonMobil's control. Fiscal terms need to be predictable and durable. If they can be changed in the future then ExxonMobil cannot make an investment decision for its shareholders. An increase in taxes during the life of the project could offset the benefits of taking it on. Because AGIA allows fiscal terms to be modified, it does not provide fiscal predictability. He said total state take must be provided.

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MR. MASSEY said alignment between the state and the leaseholders is essential to a basin-opening project of this magnitude. It is important that AGIA bring upstream and midstream together and provide for an integrated proposal, because the upstream pays for the midstream. The upstream is the revenue generated from the sale of gas and liquids. To calculate that, there must be clarity on the taxes and royalty, which must be set at a level that makes the project viable. Any proposal must demonstrate how a successful open season will be achieved. To insure the best result, AGIA should establish broad key objectives and allow applicants flexibility in meeting them by providing requirements they feel are necessary to make the project viable. It would be best to let applicants determine if they need capital contributions from the state. It is important for the state and explorers to have access to the project so their gas can be treated and transported to markets. It must be attractive to the shippers when they make their initial FTs. The shippers that must invest substantially to explore, develop, and produce gas will not be able to enter into long-term financial commitments for the transportation of gas if there is a likelihood that the rates will increase in order to accommodate expansions. Under the Alaska Natural Gas Pipeline Act, Congress struck a balance between encouraging investments by those willing to commit the initial capacity and those who explore.

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MR. MASSEY said because of the unique nature of the Alaska gas pipeline project, the Federal Energy Regulatory Commission (FERC) approved unprecedented policies to enable a FERC-mandated expansion to benefit explorers. The issue of how potential future shippers may access initial capacity and future expansion capacity, if needed, should be administered by FERC. Shippers should not be required to subsidize other expansion gas holders at 115 percent of initial maximum rates due to a mandated roll in of costs. A 15 percent increase could increase the FT commitment by \$0.30 to \$0.50 per MBTU on gas shipped, which is

\$500 million to \$800 million per year on the initial shippers. The expansion shipper might like it, "but at this state we don't know who the expansion shipper might be." It is too high of a risk. The pipeline entity should not have to accept a FERC certificate irrespective of FERC-imposed conditions. The upstream inducements require significant modification to ensure a commercially viable project. It would be better to leave the issues open and allow the applicant to make a proposal to address those necessary terms. AGIA prescribes activities that must be completed within a specific timeframe. Setting arbitrary target dates is not good management. Milestones are not necessary if the project is commercially viable. The producers will progress the project at the maximum prudent pace consistent with the industry-proved gate process for project development.

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MR. MASSEY said AGIA gives commissioners broad authority to adopt additional requirements and establish regulations. AGIA doesn't establish criteria for evaluating proposals and selecting a successful bidder, which is likely to lead to litigation. The parties must have an impartial means of handling disagreements. Binding neutral arbitration is widely used in commercial agreements and is not a new concept in Alaska. Alaska courts have recognized a strong public policy in favor of arbitration. He said ExxonMobil is committed to move the pipeline forward. He suggests that AGIA be amended to allow each applicant to decide how best to meet the state's objectives. The state can then accept the proposal that delivers the most value.

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SENATOR WAGONER asked if ExxonMobil is saying that if the state leaves rolled-in rates and the 15 percent in place, that ExxonMobil and the other producers will not participate.

MR. MASSEY said he described where AGIA is very prescriptive. "It also removes an applicant's ability to argue in front of FERC what they think is right and in the best interest of the project or them as an initial shipper or an expansion shipper. It is too prescriptive. As a result, I'm encouraging that it be removed from the bill. FERC will decide what is right no matter what we put in this agreement. They have the responsibility for overseeing these rates, and they will do it."

SENATOR WAGONER said if it is left in AGIA and the state selects a proposal, the proposal goes to FERC and if they didn't accept the rolled-in rate and the 15 percent, then, at that time, the

argument could be made to change it. "Seems to me like either process would work."

MR. MASSEY said if ExxonMobil agrees to it, it would be required to put it in front of FERC, and that does not mean that FERC is going to agree. It doesn't mean some other shipper may protest and is not a party to the agreement. This is a long-term deal, and it is difficult to predict where things might land. It might not even be in the best interest of the state to have it in the agreement, because the gas that may be flowing may not be its gas. It could be gas from federal lands, "but you're required to subsidize that." There is already a process for dealing with expansions and rate changes, and that is FERC. "We should be careful to prescribe things that may sound good, look good today, but we're entering a very long-term relationship that we can't today predict what the situation might be."

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SENATOR WIELECHOWSKI said Mr. Massey has talked a lot about fiscal stability. ExxonMobil has been in Alaska for many years. When the oil pipeline was built, there was no locked-in tax, and ExxonMobil has made billions, probably hundreds of billions, in profits. He said he read an article in Wall Street Access that was disturbing. It said there is unlikely to be an Alaska gas pipeline in ExxonMobil's future because Alaska has been an unreliable partner, as quoted by ExxonMobil's CEO. Senator Wielechowski said he understands how important stability is, so he looked at where ExxonMobil is partnering to compare with Alaska. ExxonMobil has major investments in Chad where there are seventy political parties and is subject to multiple military coups. Chad recently threatened to throw several oil companies out of the country. It has one of the top ten largest pipeline projects in the world, and ExxonMobil is part of that. ExxonMobil participated significantly in Equatorial Guinea, which was recently rated as one of the worst dictatorships in the world. It has widespread torture, arbitrary arrests, and a total corruption of government services. ExxonMobil is in Nigeria, Libya, Bolivia, Indonesia, Angola, and Kazakhstan, and it is looking at investing in Iran, which just seized 15 British soldiers. "I am just wondering if you believe those countries are more reliable partners and provide more fiscal stability than Alaska does."

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MR. MASSEY said the discussion is about what is required to allow the pipeline to progress. "Without stable fiscal terms, I don't know how to make an adequate investment decision. It is

not like a small drill well in west Texas. This is a mega project and the fiscal terms--I have to know what they are and I have to know what they are going to be over time, so that I can make an adequate investment decision. This is such a huge project that it will have an impact on ExxonMobil as big as we are because of the magnitude of the capital investment that's required to put in this project. We can't make that capital investment and then a few years later, that capital investment is no longer viable."

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SENATOR WIELECHOWSKI said ExxonMobil didn't get a tax lock-in when building the oil pipeline. Alaska has been very fair with ExxonMobil and the other oil companies. He said he finds it insulting that ExxonMobil doesn't trust Alaska and says it isn't a reliable partner.

MR. MASSEY said it is not a matter of trust; it is a matter of knowing the fiscal terms to make an investment decision. "And until it can be agreed, between ourselves, how we're going to share the benefit from this project, then I'm not able to make an adequate decision."

SENATOR STEDMAN said Mr. Massey needs transparency and predictability. The tax structure on the books is transparent. The bill has a transparent and predictable time frame. "What am I missing?" The bill talks about ten years, he added.

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MR. MASSEY said the bill includes ten years of fiscal stability for gas production taxes. There are several ways for Alaska to tax the project, including property taxes, oil taxes, and corporate income tax, so a small lock-in on gas production tax doesn't give the full scope of fiscal terms throughout the life of the project. He can't run the economics and make a good decision without knowing the taxes he will pay. The pipeline is going to be the revenue generator for ExxonMobil in the future, so fiscal terms must be identified.

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SENATOR STEDMAN asked if all state and federal taxes are equally important.

MR. MASSEY said ExxonMobil follows the principal that it is perfectly acceptable to work with the resource owner--Alaska. "We're in this together. Your resource doesn't get to market unless it's viable and I can't build it for you unless it is

viable for me." The federal government doesn't own the resource, so the state and the lease-holder must define what it takes to make it work, he stated.

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SENATOR MCGUIRE said the comments centered on the building of the pipeline and it being a highly-risky mega project, "so let someone else build it." She asked what ExxonMobil would do if someone else puts the money up and builds it, and the open season comes up and ExxonMobil needs to make a decision and lock in ten-year gas rates. She noted that rolled-in tariffs are used by Imperial, ExxonMobil's counter part in Canada, so it is not unfamiliar to ExxonMobil.

MR. MASSEY said a successful open season will only work if the project is commercially viable to the shipper, and in this case the shippers are the producers and the state. So if it is not commercially viable, then it will not be a successful open season. AGIA does not provide for a commercially viable project.

SENATOR MCGUIRE said, "So, you pass up the open season because you make the decision that it is not commercially viable for you. And there are two other major producers along with independents that have led to great discoveries through exploration over the next couple of years, and together they make the firm FTs that are needed to get the gas moving. No way around it. There's a company that's going to agree to build it; it's being built; the FTs are there; you've passed up your open season; you've given up your opportunity to lock in your tax rates. What'll your shareholders have to say about the fact that you've given up the opportunity to monetize your gas?"

MR. MASSEY said if ExxonMobil decides it is not viable then other companies will make the same decision.

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SENATOR WIELECHOWSKI asked if the producers talk among themselves about making bids during an open season.

MR. MASSEY said, "No, we cannot. It is an independent company decision which we cannot share with one another. And those commitments are binding commitments on individuals companies" He said they can share plans for Prudhoe and how they will develop the gas at Prudhoe Bay and Pt. Thompson. "But the individual commitments that are made by each company will be private and not discussed. No one will know until the bids are open."

SENATOR WIELECHOWSKI asked, "If this is an economic project, but a project that's built by independents as opposed to producers, and it's an economic project...you will not participate in an open season?"

MR. MASSEY said a successful open season will only happen if the project is commercially viable to the initial shippers.

SENATOR WIELECHOWSKI asked again.

MR. MASSEY said if a third party builds it and it's commercially viable, then ExxonMobil will participate. "The question is whether it is commercially viable being done by a third-party participant. That's a question we will answer at the time."

SENATOR WIELECHOWSKI said this project is a national priority. "Do you think Congress would look very favorably upon an open season that was deemed to be economically viable and you didn't show up?"

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MR. MASSEY said he will be comfortable in explaining ExxonMobil's position to anyone. "We cannot make a commitment to a project of this magnitude if it's not viable for our company and for our shareholders. That will just not happen."

SENATOR STEVENS asked Mr. Massey to be more specific about what fiscal certainty is.

MR. MASSEY said, "We would propose that AGIA be amended such that there're broad objectives that the state wants to achieve [and] let the applicants make a proposal that describes what they need in terms of making the project viable. And then also describe how they intend to meet the state's objectives, and included in that will be, what sort of terms for fiscal stability are necessary. It's difficult for me to sit here today without looking at the whole scope of the deal to give you a particular period."

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SENATOR WAGONER said a few years ago people came by who weren't producers or shippers but distribute natural gas to commercial and residential customers. They also have some commercial generation capacity throughout the lower 48. "Would it be feasible...if they came to either yourself or another producer on the slope and were interested in purchasing gas from you...and then them committing to open season with that gas they've made a

commercial arrangement with you on. Is that going to be something that some of the producers would consider?"

MR. MASSEY said the gas is always for sale.

SENATOR MCGUIRE said sometimes it doesn't feel like it.

MR. MASSEY said the gas is for sale but it has to be sold at a market-related price and ExxonMobil has to have confidence that the project the buyers are pursuing is viable. "Obviously if somebody would be willing to come up there and make that FT commitment and build the pipe themselves and give us a market price for the gas and we believe their project is viable, sure we would sell our gas."

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SENATOR STEDMAN said that was confusing. It would be a demand-driven open season, and "wouldn't you still face the same issues you face today in the fiscal arena that you operate? How would you solve those, or are they irrelevant if it's demand driven?"

MR. MASSEY said, "In that gas arrangement, we would work some sort of deal with the person purchasing the gas to provide the stability that we would need. They would have to guarantee that stability, which could be done. Or we would have to go to the state and guarantee that stability. So, regardless, you're going to have to get the stability some way or another. It could be done through that transportation arrangement as Senator Wagoner described. Or it could be done with a gas sale, but is handled through the state at the same time. It still would have to be there in some form or another."

SENATOR STEDMAN said one scenario is ExxonMobil asking the state for fiscal certainty, and the other would be somebody else coming to the state and leveraging for the same fiscal certainty, because the fiscal certainty appears to be driven out of the three majors that have the gas.

MR. MASSEY said that is correct.

SENATOR WIELECHOWSKI said it is hard to understand. "There is an \$18 billion federal loan guarantee. If someone comes forward and the federal government deems that to be an acceptable project, they're willing to offer \$18 billion—unprecedented as you said. I guess I'm having a hard time seeing why you see that as a problem."

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MR. MASSEY said financing is a very complicated subject, and he would be happy to bring in financing experts. The federal loan guarantee doesn't kick in until the project starts. The risk of completion is the greatest risk and will be on the backs of the shipping commitment—those that are making that commitment. "Because they are responsible for paying for that pipe no matter what it costs when they sign up for that commitment." It is very complicated. The loan guarantee will help get a lower interest rate, but it doesn't remove the completion risk that falls back to the shipper and builder.

SENATOR WIELECHOWSKI said the gas is sitting in the ground. "It's not making you any money. If someone else is willing to take the risk of building the pipeline, that's not costing you anything. If the pipeline doesn't get built, you're right where you're at. Your gas is still sitting in the ground. So if someone else agrees to build it and you go to open season and the pipeline fails for some reason, you've lost nothing." He asked what the risk is to ExxonMobil to come to an open season if someone else built the project.

MR. MASSEY said the federal government is not backing the completion of the pipeline; the costs for building the pipeline and the risk associated with its completion are borne by the shippers. "I don't know of a company that can build a pipeline without a firm transportation commitment. Maybe there's a company out there, but I don't know of one."

SENATOR WIELECHOWSKI asked why wouldn't ExxonMobil go ahead at an open season and bid its gas. He asked what the risk is.

MR. MASSEY said if the pipeline is not commercially viable, then we won't bid our gas.

SENATOR STEDMAN said there are legal briefs, 2005 and 2005a, in his office and he asked what those are and what FERC's role is.

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MR. MASSEY said it all began when the Alaska Natural Gas Pipeline Act (ANGPA) passed in 2004, which gave ExxonMobil the confidence it wanted in the federal legislation to progress the project. It describes what to do to get the permits and establishes a federal coordinator to guide the different federal agencies. It also established that FERC should rule and put out open season regulations. FERC did that in 2005. Even within that FERC order they put out an order that there will be a

presumption of rolled-in rates. They will judge those cases on the basis of that order, he explained. Some have misinterpreted that ExxonMobil's court challenge is about rolled-in rates. "The presumption of rolled-in rates is there, and that is not what we're challenging." It is challenging one small aspect of the FERC open season regulation, "and that is: does FERC have the ability to order a design change. We believe that is beyond the scope of FERC today. We don't want to get in a position where we have progressed the project right to a FERC certificate at about \$1 billion and then FERC orders a design change, and we have to go back and start over." There was debate when the open season regulations were being put together, "but that's behind us now." The issue that is left is the ability to make a design change.

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SENATOR STEDMAN said the bill seems to have everybody agree with each other and not challenge things. "Is FERC biased to the industry or to the state or are they independent?"

MR. MASSEY said FERC is the regulator, and he can't say who wins, but ExxonMobil is comfortable working in front of FERC. He believes they take all views and will land on a decision that everyone is comfortable with.

SENATOR MCGUIRE noted that Mr. Massey said that one problem with AGIA is that it put too much demand on expansion of the line, "and that you would prefer that to be something that FERC would deal with." But Mr. Massey just said that the part of the 2005 opinion that ExxonMobil is challenging is the ability of FERC to order a design change. She asked if a design change is different from an expansion order or an access order. "On the one hand you're saying you'd like FERC to have more authority over the very things that we'd like to demand here—expansion of our pipe, access to our pipe so that our independent explorers can bring more gas into the system. And on the other hand you're saying the part of the opinions that you're challenging is their authority to order a design change."

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MR. MASSEY said a design change has great risk, and the state should see that. "We could get to the point where we have spent significant sums of money and be ordered to make a change in the design and have to come back and redo that work." ExxonMobil doesn't have a problem with expanding the pipe after it is built. There is a belief that ExxonMobil would block an expansion, and he doesn't know why it would do that if it was the pipe owner. ExxonMobil wants the parties to make that

decision. In 10 percent of the cases it may have to go to FERC to be resolved. Under ANGPA, FERC was given the authority to mandate an expansion, so it's impossible to prevent someone from getting an expansion. "They just have to go to FERC and prove their case and then they will get their expansion."

SENATOR MCGUIRE asked, "So if that is the case, then why would you mind if AGIA simply reaffirmed your statements on the record here today. Every two years you take a look at it, see whether or not you to expand it as you said on the record you'd like to have more gas in the pipe and that's everybody's goal. Why not simply reaffirm that in our state law the same way we have in the federal ANGPA and certainly your statements here on the record. Why not just do that?"

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MR. MASSEY said he was talking about the requirement that ExxonMobil has to support rolled-in rates that could increase the tariff by 15 percent. The state may not like it either. There is an agency where the pipeline owner and shipper can go to state their case. Then ExxonMobil can go in and have that discussion, and then FERC will make that decision.

SENATOR MCGUIRE asked the definition of commercially viable.

MR. MASSEY said it is very complex, and it involves economics, exposure, and risk management.

SENATOR MCGUIRE asked if he considers supply of the whole system. "If you were to bring your gas to the market, there's a chance that it could lower the price of gas as a whole and potentially detrimentally affect your investments in other places, such as Iran." What profit margin is acceptable?

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MR. MASSEY said ExxonMobil looks at the project as a stand-alone investment decision. He said operations are not allowed in Iran. "No subsidiary of a U.S. based company can have operations in Iran, to my knowledge." Profit margin looks at total cash flow, the investor's rate of return, return on the capital, and present value from the cash flow. It will be analyzed across a multitude of different variables, and "then land on whether we think we got a good shot at making it."

CHAIR HUGGINS said this committee sees its role as facilitating partnership cooperation, but ultimately success in getting the gas pipeline. He called the commissioners forward.

SENATOR WAGONER said, "Wouldn't your answer have been the reason Exxon doesn't want to participate on the open season is 'cause you don't know the tariff and how high the tariff's going to go, because you don't know who's going to control the project and what the final expense on the project's going to be?"

MR. MASSEY said that is a good explanation. Regardless of who builds the pipeline, the shipper pays for it. "And if you're paying for it, you want to manage it."

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CHAIR HUGGINS said making the assumption that it will be 10 years before first gas, the critical event is the open season.

PAT GALVIN, Commissioner, Department of Revenue, said the critical step is open season. There isn't a single open season, but there could be a series of open seasons to get the gas necessary to finance the project. AGIA provides inducements on the initial open season. "We're at a better opportunity for success if we get the gas commitment up front at that first one." But there is the opportunity to have additional ones. That is why AGIA is designed to make sure that the project will advance beyond that initial open season. Having success at the open season is the critical path for the project.

CHAIR HUGGINS said an unsuccessful open season will make him weak-kneed.

MR. MASSEY said there is no question that the open season is important, but more important are the producers and the state agreeing on a contract that describes the fiscal terms that will allow the project to progress. "I can guarantee you if we can agree to that we will have a successful open season." Otherwise the chance of failure is very, very high.

CHAIR HUGGINS asked how the state can facilitate the alignment among the players so there is a successful open season.

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MR. MASSEY said the state and the producers are well aligned to begin with. Both want a project and both see that there is a commercially viable project to be had. For a project of this magnitude the state and ExxonMobil have to be in sync.

TOM IRWIN, Commissioner, Department of Natural Resources (DNR), said he is glad to hear ExxonMobil say that the project is

commercially viable. "As a committee you need to understand that everything we have heard [from the producers] to become commercially viable is an independent negotiation. How much the state has to give to give certainty [to the producers]...is undefined. We've asked many times...to define this certainty. And so when we talk about clear alignment, the alignment comes if the state gives, from everything I've heard. If that's different, we're certainly willing to listen."

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COMMISSIONER GALVIN said there is alignment between the state and the producers for moving the project forward. The only area of disagreement is when an actual agreement is signed. Clearly, ExxonMobil believes it must be done now, and what AGIA does is allows that opportunity to take place at some point, but we are now at loggerheads. The producers' must-haves and what the state is willing to give needs to change. He said the state is not going to change the dynamics of the situation, and everyone needs to reach alignment: gas lessees, state, and pipeline builder. "What we're trying to do is to allow the project to hopefully gain some more clarity, eliminate some uncertainties, so that that discussion can take place in a different dynamic than we have right now."

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MR. MASSEY said it is important that ExxonMobil is asking for something that is standard for mega projects. It is done everywhere with mega projects. Until ExxonMobil can get to a common understanding that that is what it takes to progress a project, it will be a struggle to go forward. It will accept all risks except the risk of Alaska changing its taxes. "Once we get to that understanding, then we can make a project go forward."

SENATOR WAGONER said if he invested in something this big he would want to make sure he got his money back. In Alberta there is a 25 percent royalty tax, and all but one percent is forgiven until the companies have recouped their investment. It is an accounting process, and once that is recouped, they go back to the 25 percent. "How would that set with Exxon?"

MR. MASSEY said there are many options. ExxonMobil just wants to know what the deal is so it can run its economic tests. "What the state has put in place, here, are mechanisms that tax because of your history, what you've put in place, and there has been a general desire to want to continue that approach to taxing. But there're many different approaches." ExxonMobil is open to any models, as long it can predict it.

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The committee took an at-ease from [2:53:58 PM](#) to [3:08:53 PM](#).

MARK HANLEY, Manager, Public Affairs, Anadarko Petroleum, said his company is generally pleased with the bill. It is all about subtleties. Anadarko is a large independent, and it is focused on exploration and production. It doesn't have refineries or gas stations, so that is why its name is less known. He showed a map of acreage in Alaska that Anadarko has an interest in. Anadarko is partnered with ConocoPhillips for some acreage. It is partnered with BG and PetroCanada in the foothills.

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MR. HANLEY said Anadarko generally looks for anchor fields, larger fields that can sustain their own infrastructure, like an Alpine-sized field. It does not look for satellites, so there is higher risk and higher rewards. The foothills area is a gas province. Wells for oil found a lot of gas, and that is where Anadarko is focused. People ask him if Anadarko will drill a well for gas, and it will probably do so to keep its valuable leases. There is a timing issue. "You don't want to strand a lot of capital...so we don't want to put a lot of dollars out in there if we don't think a pipeline is going forward." In the foothills, Anadarko has four pretty well-defined prospects that seem good. Anadarko just contracted to build a new rig, and there are partners on line to actually drill a well next winter. He said he thinks there is gas down there, but it may not be enough to be commercial. But one well isn't enough to go to an open season, he said. "We can't make a long-term commitment without understanding the field and how it's going to perform."

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MR. HANLEY said if things move forward on the pipeline, "our preference would be at the initial open season, but just to be honest with you, the odds that we could be at an open season, if it's held within about three or three and a half years, is not very good because it's going to take us one year just to get the first well and a number of years to drill enough delineation wells." But if Anadarko drills next winter and if it looks like there will be an open season, "we may decide to get a couple rigs and try and delineate that thing as fast as we can to get in the initial open season. If it's a little slower, we'll go probably test another prospect. We've got a three-year plan to try and test all three of these prospects, and then we'll make decisions based on where we see things going." If there is an open season within three and a half years, there is a good

chance it will come in two years after the initial open season and ask for an expansion. That is not unusual, he said, and the pipeline itself will decide how to handle it. "They may either— if it's just adding compression or compressors, they may be at a point in the process where they can actually add those as part of their construction or they may not." It may have to be put off until after pipeline start up. "We're hoping that if this thing moves forward and we don't make the first open season, we clearly want to have things identified well before start up."

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MR. HANLEY said Anadarko likes the process in SB 104 and some of the specifics. It gives Anadarko a chance before a deal is done to get its issues out on the table for policy makers to address. "We feel like having ours considered at least earlier in the process is easier than having something handed back. And we have two shots at it during this process. We have this process before you even pass the bill and applications are submitted, and then we have the process during the public comment period before the license is actually granted, and maybe a third because it goes to the legislature where we'll have an opportunity to presumably give comments."

MR. HANLEY said Anadarko feels like its comments are being considered and the process is good and transparent. "We like that." Referring to the construction inducements, he said, "having the state put some skin in the game obviously helps." He said some have suggested the inducements at a different point. Putting the money into the pipeline to reduce the tariff is important. He thinks the commissioners understand Anadarko's perspective. "If the state's putting in \$2 billion, if you put it in the upstream it can improve the overall project economics, but it hasn't improved the pipeline. If you put it in the pipeline it reduces the pipeline costs, so...this is going to actually reduce the tariff and improve everybody's economics, whether you're an expansion shipper or an initial shipper or whatever. I think that's the appropriate route." About 70 percent of the money will come back through a lower tariff. It is a big investment and says something to people, he stated.

CHAIR HUGGINS asked about [the state] having a choice between a bidder that wanted the money and one that didn't.

MR. HANLEY said, "If it's going to reduce the costs, I would say we prefer it be reduced. If the state's willing to put some money in and actually reduce the cost for everybody, I think that's our preference."

CHAIR HUGGINS said some people suggest putting the money contingent on a successful open season. "You get the money; it's just at a different point. It's an incentive."

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MR. HANLEY said the application requirement of providing a detailed description is helpful to "all of us." On page 5, the language requiring an "estimate of rates and charges for all services and a detailed description of all access and tariff terms" is valuable. It is the appropriate language, but it only applies to the LNG project and should be moved up in the section so that either route, the highway or LNG, will be included. He noted that sometimes it is important to know what the operating pressure of the pipeline will be and the gas quality requirements. Page 6 contains the idea that people will assess market demand through nonbinding public solicitations or other methods, and "we like that idea." He agreed that ExxonMobil is a large company that can get projects done and do them well, but his concern is that normal motivations change when a producer owns the pipe. Independents build pipelines all over, and producers are always riding on them. The producers would have a desire to keep the costs as low as possible. He said there are concerns, however. The normal tension that exists is a pipeline company saying the pipeline is risky and asks FERC for a higher percentage, and the shippers say it isn't risky and ask for a lower rate of return. "FERC's going to listen to that and that's the normal tension that occurs." A producer-owned pipeline would not have that tension. The producers aren't going to oppose a high rate of return on the pipe. "Our concern is that the higher the rate of return on the pipe, that's the higher the tariff is--that means the lower wellhead value for explorers, producers. But if you're aligned as a producer and a pipeline owner, it is one pocket into another, and, in fact, the higher the tariff is the lower the state's share because of the wellhead value. So you almost automatically have an incentive to argue for that higher tariff." A producer-owned pipe won't keep the return low.

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MR. HANLEY said the incentives are not the same. Originally producers were prohibited from owning any part of the pipe. This pipeline will be a monopoly, and it needs to be looked at extra carefully. If the pipeline is owned by a pipeline company, it would want to expand, and a producer-owned pipeline might not want to do that.

SENATOR STEDMAN remarked that it seems possible that if the producers build a pipeline, they will divest themselves of it in the future, alleviating Mr. Hanley's concerns. He suggested requiring a divestiture after so many years.

MR. HANLEY replied that the producers may not want to divest, and there will be things set in the beginning, like the rate of return. Including the language in AGIA is important. He wouldn't suggest a required divestiture.

CHAIR HUGGINS said Mr. Massey believes some of the language is redundant, and he has faith in FERC. He asked Mr. Hanley if FERC is even handed.

MR. HANLEY said FERC is a good venue, but there are challenges going on right now. He referenced a case where the FERC rules that were supported by the state and by Anadarko were challenged by the three producers. The following FERC language is being challenged by the producers:

In reviewing any application for an Alaska natural gas project the commissioner will consider the extent to which a proposed project has been designed to accommodate the needs of shippers who have made conforming bids during an open season as well as the extent to which the project can accommodate low-cost expansion and may require changes in project design necessity to promote competition and offer a reasonable opportunity for access to the project.

Mr. Hanley said, "That is the heart of what we've been talking about. You see some of that low-cost design language that's in here—that's specifically in here—and...that section is what they're trying to get removed. So it causes us concern." It is a good thing to have some of that language in the bill, including the low-cost expansion language. "I wouldn't say don't let them build it—they have great expertise. I suspect if they actually wanted to submit a bid, they're going to be hard to beat."

SENATOR WIELECHOWSKI asked if the producers are really the only ones that can build this project. "Do you deal with non-producer pipelines, and what has your experience been on those?"

MR. HANLEY said Anadarko deals with a lot of pipelines that it doesn't own, and it goes head to head with them. There are other big pipeline companies that will likely come before the legislature and suggest they have experience. Anadarko is an

exploration company and doesn't drill wells; it manages the wells and those drillers. The producers won't necessarily be building the pipe themselves; they will manage it. He agrees that the "Exxons of the world have a great reputation for managing costs," but he thinks other companies have the ability. The financing will require commitments from shippers, so there is a chicken and egg situation.

SENATOR STEDMAN asked if there will be enough gas from Anadarko, Pioneer, Shell and others to underwrite the pipeline construction by the time of open season.

MR. HANLEY said no. Anadarko may not be able to be at the initial open season, unless the timing changes. "We're going to be either a small part of the initial open season or into the expansions--us and others that are out there."

SENATOR MCGUIRE asked for Mr. Hanley's opinion on the commercial viability of the pipeline in ExxonMobil's view.

MR. HANLEY replied that he couldn't speculate.

SENATOR MCGUIRE said she likes his positive attitude towards the pipeline whereby Anadarko is going to give it a shot.

MR. HANLEY replied, "I will say...when we talk about risks in the pipeline, if we show up at the initial open season, we will take the same risk...depending on volumes...more or less. But we will take that same risk, but we do have more risk in ours overall, as well, because we have exploration risks that Prudhoe Bay doesn't have. I mean, we don't know if our fields are going to perform. We have a development risk cost. Most of the development costs are already covered at Prudhoe Bay. So they have--don't get me wrong, they still have the risk of price and cost overruns on the pipeline and all the things that were described earlier--but they do not, at least, and to a lesser extent, they have more risk at Pt. Thomsen because they have discovered reserves, but Badami did too, and when they turned the spigot on, it didn't flow like they thought it was, so there's still risks there, but...the risks of raw exploration is much greater on the exploration side. So our costs are going to be higher on an MCF basis. So when we look at what we're going to do, we're going to have to see the numbers that everybody else sees. I would say our gas is going to be less economic than the gas at Prudhoe, and all we can do is look at the publicly available numbers, look at the kind of tariffs that are out

there, and try and determine whether or not we think it's worthwhile."

SENATOR MCGUIRE asked if Anadarko had the known proven reserves, would Mr. Hanley believe this project was commercially viable.

MR. HANLEY said he couldn't answer that.

SENATOR STEVENS asked if Anadarko is worried about access denial.

MR. HANLEY said that it is a concern. He said the producers' challenge to FERC to take away Anadarko's ability to get into the pipe or if it's designed properly, "so we see things along the way that concern us."

SENATOR STEVENS asked for other entities with similar concerns.

MR. HANLEY said any company that wants to get in on the expansion. There was testimony last year regarding the pipeline contract on concerns about getting into the pipe. There are those in Alaska who are interested in exploring but don't have identified reserves yet.

SENATOR WAGONER noted that Anadarko will lose its fiscal certainty if it doesn't participate in the initial open season.

MR. HANLEY said that it is a concern. "On an equitable basis, if people are making commitments to the pipe and there's a legitimate certainty that's there, it's no different for people that come in at different points in the pipeline. I would suggest that they feel like they should have the same types of certainty. So the debate that's out there...I think I understand there's supposed to be an incentive to really get people to go into the first one, but one of our arguments would be, what if you come in two years later and you're still in on the first shipping but you didn't get fiscal certainty. It will affect our decisions as we go forward just as it does everyone else's out there. We would probably argue that it ought to be, if you commit gas to this pipe, you get the fiscal certainty, whatever that might be that the legislature and the administration feels is appropriate. Because we'd like to have that more certainty on the royalty valuation methodology; the 'higher of' concerns us all the time too, and some of the other issues."

CHAIR HUGGINS asked if certainty is important for explorers and producers.

MR. HANLEY said, "As much as we can get." He added that different areas are important to different people. It is a moving game, and "with our exploration plan, we're going to try and sink as little money as we can into proving up some reserves to hold our leases to the point where hopefully we can get a pipeline that we feel comfortable is moving forward under terms that we think are reasonable and our prospects are economic and then we're going to try and development them."

CHAIR HUGGINS asked if there is an unsuccessful open season and Anadarko has proven gas reserves, "are you going to come forward subsequent to that...and commit your gas?"

MR. HANLEY replied Anadarko would approach the pipeline like everyone else to see if money can be made. He said everyone will have to wait. Not everything can be answered now.

CHAIR HUGGINS referenced a chart showing varying gas prices. He said, "It shows if gas was \$6.50, in a three-year scenario, the state would lose \$6.5 billion with a three-year delay. There's a provision in the contract that creates what I will call an accordion. If you have the financing, you've got to get started in one year; if you don't, it's five years. That will be a significant amount of money for you if you come to that open season with that delay if you accept the argument that delay equals major loss on the part of people that have committed to the project. Tariff goes up potentially. You're thoughts?"

MR. HANLEY agreed that delay is a problem and said that it is an issue for all involved. Once the decision is made to go ahead, people want to start as soon as possible. If the pipe takes a while, it'll be a risk, he said.

CHAIR HUGGINS asked what would push Anadarko to explore more.

MR. HANLEY said that progress on the pipeline is the catalyst.

SENATOR WIELECHOWSKI asked for comment on the importance of rolled-in rates to Anadarko and to encourage exploration.

MR. HANLEY replied that they are important, and the language in the bill doesn't require rolled-in rates. FERC is the decider. The bill requires the pipeline owner to ask for and support rolled-in rates. The 15 percent cap would get through two compressions and maybe the first looping. The pipeline company wouldn't care, but the shippers would disagree. A producer

owning the pipe would wear two hats. The pipeline part of the company may support rolled-in rates and the shipping side—the initial shipper—would probably say no. The policy call should be whatever makes the most sense, but Anadarko, as an explorer, likes the provision. Everybody is looking at their bottom line. He suggested looking at the Canadian system where they generally use rolled-in rates and there are “no property rights to a specific right when you get that.” The Canadians believe there are benefits to expansions, like adding to the security of the pipe, which benefits all the users. He noted that two-thirds of this pipe will be in Canada; so explorers in Canada might get better rates.

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SENATOR WIELECHOWSKI asked if rolled-in rates tend to lead to more exploration and more expansion.

MR. HANLEY said that he would think so, “but ask a pipeline company.” He referred to the debt structure of 70/30 “regardless of what you apply for.” He appreciates the state trying to keep tariffs low, and that is another example of that. He referenced the evaluation criteria in AGIA and said they are appropriate. How the applicant plans to manage cost overruns is critical. “You can go to an open season and you’ve got to be careful because if it comes in way over...” There are ways to protect yourself with contingent bids and he gave the example of: “if somebody says the tariff’s going to be \$2.30 and it goes to \$4.00, you’re not committed on the pipe, and then whose risk is it, if they’ve built the whole pipeline?” There are tensions as a rule, but it is a much bigger scale, he stated, so it is a significant risk.

CHAIR HUGGINS suggested that contingencies may make it difficult to get financing.

MR. HANLEY agreed, but said, “There are agreements to share risks where the pipeline now has the same incentive if you come in on time on budget or under budget. There are incentives. If you don’t, you pick up a share of it. Now there’s no incentives to go over those kinds of things...That’s a big issue on the cost overruns. You should get people to see how they do it. This is not, maybe not on this scale, but these issues are there every time a pipeline is built, so they’re handled somehow. And I think it’s worth understanding that, to see what those risks are.” Referring to Page 9, “the extent to which low transportation rates, again, it’s just focused on low rates, which we think is a good idea. Accommodate low-cost expansions—

this is just the criteria they have to present in how they're going to handle these things. So we like that. We want to see a pipeline design that preferably will handle low-cost expansions, and hopefully the first expansion will be beneficial to everyone. In other words, the rate will go down for everyone because it will be rolled in and the compressors will be out there."

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MR. HANLEY referred to the resource inducements. "If we're not going to be on the initial one, if there's value, which we think there is, and we think you've identified some of the issues that are concerns. The royalty valuation methodology for any of our leases that are out there has always been a point of contention among the industry [and] between the state. And tax certainty. Both of those. So to the extent that it's going to be available, we think anyone that commits on the line, whether it's first open season or otherwise, makes sense to, we would argue, to give that certainty, whatever you choose to give." He said Anadarko is still assessing smaller details [of AGIA]. "If you wanted to change that to make the resource inducements apply to everybody, I could make it real quick—give you an amendment. But, anyway, that's a policy debate as to whether it should just be those in the initial open season or those otherwise. We would argue everyone should get it, and we can fix that easily."

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CHAIR HUGGINS noted that Anadarko and BG are doing some exploration, "but your appetite is restrained until the point that you see the pipeline really going forward?" He asked if the trigger will be the successful open season.

MR. HANLEY said yes, a pipeline going forward, which will probably take a successful open season.

CHAIR HUGGINS asked what else would be an incentive.

MR. HANLEY said a successful open season suggests they are going through the certificate process and then construction.

CHAIR HUGGINS suggested that Anadarko's profile of risk is low until success is evident.

MR. HANLEY agreed, and said everybody's risks are low before the commitments on the pipe. He said, in summary, Anadarko likes the process and appreciates the ability to comment and participate

from the beginning. He said Anadarko likes a number of the provisions, as mentioned, in AGIA.

The committee took an at-ease from [4:00:45 PM](#) to [4:12:10 PM](#).

DAVE VAN TUYL, Gas Commercialization Manager, BP-Alaska, said the committee will hear familiar themes. He said BP wants and absolutely needs a pipeline, and "we need that pipeline to be built for low capital costs and to be able to be operated efficiently at a low cost." Low costs are good for BP and the state, because it will result in lower tariffs, higher netbacks, and more revenues for both. It will provide incentive for future exploration. The low-cost pipeline needs to be built in the first place for this all to happen. The pipeline project is hugely important to the nation. It's the largest known undeveloped gas resource in the United States and in BP's global portfolio. The project extends the economic life of Alaska's oil production for decades to come, he said.

MR. VAN TUYL explained that BP shares the desire to start the project and wants to work on a balanced fiscal framework. BP's Alaska future is directly linked to this project. It needs to be done right. AGIA is the administration's commitment to advance it openly and transparently. There are a number of areas of concern in AGIA. He said it may create unintended consequences that could jeopardize getting the gas to market quickly. AGIA would result in an exclusive winner before any real work is done, and it awards state funds based on promises, not results.

SENATOR WAGONER said Mr. Massey expressed a lack of clear criteria for the state to assess the proposals. But, "if you give the answers to the test, then people are going to shape the proposal toward the answers instead of shaping their proposal toward the best proposal they can perform."

MR. VAN TUYL said BP feels that the best way to allow for competition is to allow concepts to be proposed. That is how the free market can generate the best possible project.

SENATOR WAGONER asked if the state will take prior experiences into account, and he believes that a company who hasn't built a line will be eliminated.

MR. VAN TUYL said there is such a provision in AGIA, but he was referring to performance on this particular project and actually delivering results beyond just promising.

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MR. VAN TUYL said that the administration has laid out criteria for a selection in a transparent way, but the project could be further advanced by setting out a clear framework for investors. From there the market will work to identify the most effective project. He said BP supports competition. FERC requires that the market demonstrate that it wants that application before awarding a certificate; that's what happens in a successful open season. There are specific desires for the project like Alaskan jobs, training, expansions, and gas access, and BP supports all of those objectives. They can, and will be, addressed through open competition. He said AGIA can result in one party subsidizing another. It specifically requires that initial shippers who financially underpin the project and bear most of the risks, to bear the additional cost of tariff increases of 15 percent or more for expansions. BP shares the expandable pipeline desire, but the state should consider the adverse consequences of requiring subsidization. This policy places risk on the initial shippers and could put the project at risk, he opined. "The issue of rolled-in rates isn't really the concern; it's the issue of subsidization." He said the state can subsidize, but it is not good policy to take risks with other people's money.

MR. VAN TUYL noted that Congress made clear in the Alaska Natural Gas Pipeline Act that rates for initial shippers should not increase if a mandatory expansion is ordered. The law states (Section 105b) that FERC shall insure that the rates do not require existing shippers to subsidize expansion shippers. FERC put in a rebuttable presumption of rolled-in rates provided it did not require subsidization by initial shippers. He read the preamble to Order 2005: "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 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."

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SENATOR WIELECHOWSKI asked if it's fair to say that any rolled-in rates lead to that kind of subsidy.

MR. VAN TUYL said there is that possibility. A rolled-in rate that resulted in an increase isn't necessarily subsidization, and FERC will have to make a judgment.

SENATOR WIELECHOWSKI surmised that the FERC presumption assumes that initial shippers will be subsidizing future expanders.

MR. VAN TUYL said it is rebuttable if the rolled-in rate resulted in a subsidy.

SENATOR WIELECHOWSKI said he can't envision a scenario where rolled-in rates wouldn't increase the rates of initial shippers.

MR. VAN TUYL said a rolled-in rate could result in lower rates for all shippers. It depends on the nature of the expansion. It could be more efficient than the base rate, he explained

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CHAIR HUGGINS asked if the existence of a subsidy must be proven.

MR. VAN TUYL replied affirmatively. He said that AGIA and federal law could be in conflict, and if that is true, resolving the conflict would add delay and uncertainty. FERC has spoken favorably about the bill, but the issue needs to be consulted before progression. "We plan to go ahead and consult with FERC in the very near future just to insure there's not a conflict problem in the future when we actually are progressing the project." Requiring a potential subsidy for shippers would be a disincentive during open season. He clarified that the producers are only challenging the issue of design change requirements after the open season. "We're not challenging the rebuttable presumption of rolled-in rates, provided it doesn't result in a subsidy." The motivation for the challenge is to ensure that costs are minimized and delays are avoided from a mandated design change.

MR. VAN TUYL said that a third area for careful consideration is the \$500 million grant; it may be attractive to underfinanced project sponsors or companies unwilling to risk all of their own money. Instead the state could ask project sponsors to propose their own mid-stream inducements. "That would give the free market the opportunity to do what it does best." The administration wants to provide the \$500 million up front because that is the riskiest phase of the project. "We have a very different view." The upfront phase is risky for a non-

resource owner who is not confident that it will have customers participate in its open season. Enbridge has that view. He said the riskiest phase for the ultimate shippers is in the construction period, when cost control is critical. Also risky is entering the open season when firm transportation commitments must be made, which means "committing real dollars to enable the project to be financed to begin with." All project risk ultimately flows to the resource owners, he said.

MR. VAN TUYL said the fourth area of concern is that AGIA doesn't address the resource framework, which is the key enabler for financing. The resource owners will pay the cost and bear the risk of building the pipeline whether they own it or not, because they reimburse the pipeline owner through the tariff cost in the toll. 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 the commitment. The details of an upstream framework are complex, but unless they are addressed the project won't secure financing.

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MR. VAN TUYL referenced a slide to show resource owner risks. They include: price, which might fall below the rate of the tariff; production, which requires a full pipeline every day; fiscal risk, whereby the fiscal terms on the upstream business might change; construction, like cost increases; regulatory delay; and the risk of financing in the capital markets. He showed another slide showing the ten largest oil and gas financing in history, and the largest has been \$3.7 billion, which is a fraction of what this project will be. All risks are taken by the pipeline company and passed through to the resource owner. The pipeline company receives a regulated rate of return on investment, come rain or shine. In exchange for a reasonable rate, it is protected from certain risks, which are passed, instead, to the resource owner. Ultimately, all risks are borne by the resource owners. It's important that the risk-bearers can manage it, so it's critical that the upstream risks are balanced with rewards. The state is uniquely positioned to manage that risk because it establishes those fiscal terms.

MR. VAN TUYL concluded with four key messages: 1) BP wants and needs a pipeline. 2) BP fully supports an open process that leads to a mutually agreed fiscal framework with the state that allows the project to advance and attract financing. It is critical that the legislature supports that framework, and the judicial branch should review it for constitutionality. The people of Alaska should be consulted, and the resulting

framework should be made available to all potential investors to insure competition. 3) Mutually agreeing on an upstream framework is critical. The resource issues have to be resolved so the owners will have the confidence to make commitments in an open season. He said he is willing to engage in developing that upstream framework. 4) A number of the midstream details in AGIA need to be fixed to avoid picking a winner in advance. Any payment of inducements should be made after the results are delivered. A sponsor could win the inducements after a successful open season.

4:41:58 PM

SENATOR WIELECHOWSKI asked if there is a master operating agreement that deals with all the North Slope producers.

MR. VAN TUYL replied that each individual field has its own unit operating agreement.

SENATOR WIELECHOWSKI asked if the Prudhoe Bay operating agreement requires one party to get permission from the others before taking gas.

MR. VAN TUYL said there are provisions for overlift and underlift, and there is the ability for any individual owner to take its gas or oil in kind, but that is limited by not interfering with operations.

SENATOR WIELECHOWSKI asked if there's a provision that requires the other owners to take gas if one owner is.

MR. VAN TUYL replied that he doesn't know of any such provision. There are over-lift or under-lift provisions, which happen all the time with tanker schedules. "I might need to underlift because the tanker that I'm planning to deliver my crude to is delayed...when another tanker is already in port. What I don't know, specifically, is how far out of, how over-lifted I can become."

SENATOR WIELECHOWSKI asked if BP would need permission from the other owners to take a certain amount of gas, or if they all have to put their gas on the market.

MR. VAN TUYL replied that one can take gas in kind if it doesn't interfere with unit operations. There are already minor gas sales so that provision is utilized. He is not aware of a provision that requires putting gas on the market.

[4:45:48 PM](#)

SENATOR WAGONER asked for an updated version of "this" with an additional column for which projects were over or under budgets.

SENATOR STEDMAN asked for the dates of the referenced projects as well. The projects appear to be the same size as the gas treatment plant.

MR. VAN TUYL said, "About that size or slightly smaller."

SENATOR WIELECHOWSKI said the numbers look low, and he thought the oil pipeline cost \$9 billion 30 years ago.

MR. VAN TUYL said he is not sure what the financial arrangement was for delivering TAPS, but he will find out.

[4:47:50 PM](#)

CHAIR HUGGINS said that he recalls another expensive project that's not on the list. It was over \$15 billion. "You might check your source." He asked if BP will apply under AGIA.

MR. VAN TUYL replied that it depends on the ultimate form of AGIA, but he hopes so. Its concerns would need to be addressed.

CHAIR HUGGINS asked if the upfront application timeline will work for BP.

MR. VAN TUYL said a project of high importance needs sufficient time to thoroughly evaluate proposals. There are certain stipulations in AGIA that might make this difficult. "The concern that we would have is could we make an adequately conforming proposal basically in good faith."

[4:50:08 PM](#)

CHAIR HUGGINS asked for BP's estimate on the project cost.

MR. VAN TUYL said the estimate was \$20 billion in 2002, but steel prices have doubled and labor costs have gone up.

SENATOR WIELECHOWSKI asked for specifics on what BP wants.

MR. VAN TUYL replied that it's difficult to say what provisions are needed; the key is getting risk/reward balance. There isn't one specific solution; there's a host of possible outcomes. Allowing applicants to propose what they want "would be a reasonable step forward, I think."

[4:52:39 PM](#)

SENATOR WIELECHOWSKI said he doesn't know how else to do this. He said he is sympathetic to Mr. Van Tuyl's concerns, but there is no way to evaluate what he wants without more specifics. He asked if the inducements in AGIA shouldn't be there, and instead BP comes and tells the state what it wants. "At any time will you come to us in an open hearing and tell us what you want?"

MR. VAN TUYL said he is not advocating a particular process; that is the choice of the state. "I'm not sure that a new piece of legislation is required; I think that the administration negotiates terms, and whatnot, all the time outside of legislation. Ultimately that would be, if that happened, that would need to go to the legislature and be endorsed, approved, reviewed by the judiciary. I think the, like I say, one process forward might be to allow potential project sponsors to propose to the state what that risk/reward balance package would look like, rather than to stipulate specific terms in the bill that might--the concern I have is that by being too specific, whether it's with the application or with the form of inducements, we may preclude the one option or the combination that allows the project to advance. I know that that wouldn't be the intent in providing that specificity, but that's just my concern."

SENATOR WIELECHOWSKI said he can't evaluate what BP wants unless he is told. "I guess my suggestion would be to put together a package and bring it to us. We're going to be hearing this for the next few weeks. I would like to see what your package is. I would like to see what exactly you want us to do, because if you don't tell us, then we're not going to know what to do--what you'd like us to do. We won't be able to fairly evaluate it."

[4:55:13 PM](#)

SENATOR WAGONER surmised that the \$20 billion applies to a pipeline all the way to Chicago. There are alternatives that will be explored like an Alberta hub and a smaller line to Chicago. He asked for a modeling of those figures.

MR. VAN TUYL replied that the portion from Alberta to Chicago was \$5 billion of the \$20 billion total. It is unknowable what the available takeaway capability will be in Alberta ten years hence. There are unknowns like the explorations in the Canadian sedimentary basin and others. So BP figured out the cost of a brand new pipe and compared the alternatives. "If we can access existing capacity for a competitive price, then that would certainly be a sensible thing to do." There may be some combination of new pipe required and use of existing capacity.

4:57:04 PM

SENATOR WAGONER asked what percent of the 4.3 BCF capacity would be taken up with liquids if the line was run at 2,500 pounds. "How many barrels of liquid would be shipped per day?"

MR. VAN TUYL said the shrinkage on the line is about six percent total, and about three percent of the gas is used as fuel in the gas treatment plant (GTP) itself, and about another three percent in the pipeline as it goes down to the market. The total liquid volume depends on the richness of the gas at its source. "My recollection is that the total liquid volume is in the neighborhood of 100,000 barrels a day."

SENATOR STEDMAN asked what percent of BP's volume will be from the gas basin if there is a four or six BCF line.

MR. VAN TUYL replied that the project would about a 12 percent increase in BP's total gas through put.

SENATOR STEDMAN asked if that would be significant.

VAN replied, "Absolutely. This project, anyway you look at it...is huge, even for a very large company like ExxonMobil or BP.

5:00:01 PM

SENATOR STEDMAN commented that there hasn't been any discussion on the cost of treatment plants. If there is a third party pipeline bidder that wins, how will the ownership and construction of the gas treatment plant fit in?

MR. VAN TUYL replied that ultimately a plant must be part of the pipeline project scope, because the gas at the North Slope contains more CO2 well beyond the pipeline spec CO2. The CO2 will need to be removed and there needs to be an initial stage of compression, which is supplied at the gas treatment plant. There needs to be other impurities removed, so that should be included in any project proposal.

SENATOR STEDMAN asked the cost of a gas treatment plant.

MR. VAN TUYL replied that in 2001 it was \$3 billion, but the cost would undoubtedly be higher now.

SENATOR STEDMAN asked how FERC is involved in the plant.

MR. VAN TUYL replied that when FERC promulgated the open season rules, it included the treatment plants as part of its jurisdiction, so tariff rates would be included in the gas treatment plant as in the pipeline. It's part of the pipeline. The service would be unbundled, which means someone purchasing the service could choose what portion of compression and what portion of CO2 removal was required.

SENATOR STEDMAN asked if it would be probable that an independent company submit a proposal and not address the gas treatment plant. If so, how would that be reconciled?

MR. VAN TUYL replied that it's hard to speculate, but a successful project must include a gas treatment plant. "I would expect that any party would recognize that, whether it was an independent pipeline or a producer."

SENATOR STEDMAN asked if the plant would be controlled by a producer.

MR. VAN TUYL said that is difficult to answer now, but ultimately he imagines the operator of the pipeline would arrange "operatorship" of the plants as well.

SENATOR STEDMAN said he was referring to ownership.

MR. VAN TUYL replied that the producers are uniquely positioned to deliver big projects and motivated to do so at low cost since that means higher netback. It would include the gas treatment plant. The plant would be regulated by FERC. It would provide the access regulations.

SENATOR STEDMAN asked if the bill should be expanded to include the 70/30 debt provision in the gas treatment plant or should the gas treatment plant be 100 percent equity, or is it irrelevant to getting the project built.

MR. VAN TUYL said that is a concern on the specificity of the tariff structure. "We fully support the notion behind AGIA of trying to ensure that the toll...is as low as possible." He is concerned about being too prescriptive up front, which may prevent the best commercial solution. "What the correct toll structure is for the GTP will ultimately be...in an ideal world, get set in the market place and it gets regulated by FERC."

SENATOR STEDMAN asked if Mr. Van Tuyl wants it to be left out of this process and let whoever comes forward with a proposal deal

with the gas treatment plant or not. "I assume it would have to be wrapped up in their proposal as they bring it forward and let them, in their proposal, recommend some form of a debt equity position along with other variables."

MR. VAN TUYL replied that that would be a real possibility for ensuring the lowest possible toll. He believes the real objective of the administration of setting the 70 percent debt component is really trying to get at the lowest possible weighted average cost of capital. That is what will drive the tariff lower.

5:09:35 PM

SENATOR STEDMAN asked how rolled-in or incremental rates affect the gas treatment plants. If the plant is at or near full capacity and someone wants to come on, would they build another one or would they expand it? Is there any relationship between the FERC order 2005 and the gas treatment plant?

MR. VAN TUYL said he doesn't know what the interplay is. The plant would be expandable because typically those plants are arranged in multiple trains. So there may be three trains initially to process 4.5 BCF a day of gas, and if additional gas came in, another train could be added. "I don't recall the specific structure of Order 2005 and what it would say, if anything, about the rolled-in rate treatment in the GTP."

SENATOR WAGONER asked Commissioner Pat Galvin about the "70/30 and whether it applies just to the pipe or the treatment plant, which is the whole project, or not."

5:11:30 PM

PAT GALVIN, Commissioner, Department of Revenue, said that AGIA allows the applicant to choose whether or not to include the gas treatment plant as part of its proposal. "If they do, then they are required to include the same provisions for both the tariff structure and the expansion that would be required for the pipeline." That provision is on Page 7 of AGIA, and it only specifies the debt to equity, not the expansion. "If they submit a proposal they can include it in the proposal itself with the understanding that they would have a 70/30 debt to equity ratio. It also requires them that if they don't include it and then subsequently own it, they will still have to be required to use the 70/30 debt to equity ratio." And that's why it's written that way. Applicants can include it or not, but they are committing that ratio at either time.

[5:15:33 PM](#)

SENATOR GREEN asked who will build it if it is not included in the proposal.

COMMISSIONER GALVIN said the market will decide. If a third-party builds the pipeline they may end up building the gas treatment plant, or the lessees may decide to build and own it.

SENATOR GREEN said that doesn't make sense.

[5:16:25 PM](#)

SENATOR WAGONER said it seems that a private pipeline company building the line would probably want to build the plant too. He can't imagine the producers building the GTP if they are building the pipeline. He said it's a chicken and egg story.

COMMISSIONER GALVIN said he would be happy to come back and expand on the issue. AGIA is being built on the idea that the government shouldn't dictate who owns what and what roles entities play in the overall system. AGIA attempts to avoid putting restrictions on people that hinder commercialization. Interested parties could comment on this. The commercial decisions of the participant may drive them to decide to have separate ownership.

MR. VAN TUYL said that BP envisioned separate legal entities owning and operating the gas treatment plant. "It may have exactly the same ownership individuals as the pipeline and whatnot, but just because...the remit of the GTP is a bit different than the pipeline that it may be a different entity but the same structure as the gas pipeline." Three or four owners might own both the GTP and the pipeline but they would form different companies.

[5:19:45 PM](#)

COMMISSIONER GALVIN said the two parts of the system have different roles. The pipeline companies transport the product, and the GTP is a much different part of the system—it is more associated with drilling than transporting. That's why there is a likely division between the two.

MR. VAN TUYL said there are gas pipelines that include treatment plants. It's not unusual to include both functions within one physical entity. And it is not exclusive either.

[5:21:03 PM](#)

SENATOR MCGUIRE asked if last year's contract had them separate.

MR. VAN TUYL replied that it had envisioned separate legal entities, but the ownership may have been the same.

COMMISSIONER GALVIN said AGIA is providing the opportunity to do it either way, but if an entity decides to own both, it is going to have to have that low cost built in.

CHAIR HUGGINS said that much of the commentary on AGIA is positive. The state has a spotty record on business enterprise. The producers need to clarify what they want, and the interaction between players needs to be encouraged. "I can tell you that if I'm investing my money, I want the business partners that show a big bottom line with a big plus beside it because that's who the best partner is." He said he hopes BP is a big player, but BP has to help the legislature help it get what it wants. "And to that extent, we are prepared to be your partner."

SB 104 was held over.

The committee adjourned at [5:24:26 PM](#).