

**PRESENT-
ATION:
COOK INLET
OIL & GAS
INDUSTRY,
2/1 1/05**



KENAI PENINSULA BOROUGH

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DALE BAGLEY
 MAYOR

Senate and House Resources Committee Kenai Peninsula Hearing February 10th & 11th Schedule of Events & Tours

February 10th

5:30pm to 7:30pm: Reception at the Challenger Learning Center of Alaska
 Next to Kenai Central High School on Kenai Spur Hwy/ Facility #283-2000
 Sponsored by Kenai Peninsula Borough & Peak Oilfield Service Company
 Hors d'oeuvres & hosted beer & wine service

February 11th

7:15am: Legislators & staff meet at Challenger Learning Center for facility tours
 Dress warmly! Wears shoes you don't mind getting dirty. Travel light!

7:30am: Tour groups depart Challenger Center

Group #1		Group #2	
9 members		4 members	
Rep. Chenault, Rep. Ramras, Sen. Stedman Sen. Stevens, Rep. Olson, Sen. Elton, Rep. Elkins, Charisse Millett, House Oil & Gas staff Dan Dickinson, Dept. Revenue		Sen. Wagoner Rep. Seaton AOGCC Commissioner Dan Seamount Peninsula Clarion Reporter Mark Quiner	
7:30am	Unocal picks up group @ CLCA	7:30am	XTO picks up group @ CLCA
8:00am	Arrive @ Unocal Heliport	7:50am	Arrive @ XTO Heliport
8:05am	Safety briefing & Mustang suits	7:55am	Safety briefing & Mustang suits
8:30am	Depart Unocal Heliport for Steelhead platform	8:25am	Depart XTO heliport for "A" or "C" platform
8:50am	Arrive @ Steelhead platform/ tour	8:40am	Arrive @ platform/ tour
10:20am	Depart Steelhead for heliport	10:20am	Depart platform for heliport
10:40am	Arrive @ heliport	10:35am	Arrive @ heliport
10:50am	Depart heliport for LNG plant/ Unocal drives group to plant	10:45am	Depart heliport for Agrium/XTO drives group to plant
11:00am	Arrive @ ConocoPhillips LNG Plant	10:55am	Arrive @ Agrium Nitrogen Plant
12:10pm	Depart LNG Plant/ ConocoPhillips drives group to CLCA	12:10pm	Depart Agrium/ Agrium drives group to CLCA
12:30pm	Arrive @ Challenger Learning Center for lunch	12:30pm	Arrive @ Challenger Learning Center for lunch

February 11th (cont.)

12:30pm: Soup & sandwich lunch at Challenger Learning Center
Lunch provided by ConocoPhillips Alaska

1:30pm: Joint Senate & House Resources Committee meeting
Presenters:
Kate Giard, Chairman, Regulatory Commission of Alaska
Dan Seamount, Board Member, AOGCC
Agrium
ASRC
Aurora Gas
ConocoPhillips Alaska
Forest Oil Company
Marathon Oil Company
Pioneer Oil Company
Tesoro Alaska
Udelhoven Oilfield System
Unocal Alaska

Attending, but not testifying:
Dan Dickinson, Director of Tax Division, DOR
Mark Myers, Director of Oil & Gas Division, DNR

5:30pm: Tentative end of Committee meeting

Attendees

Senators

1. Senator Tom Wagoner, Chair Senate Resources Committee
2. Senator Bert Stedman
3. Senator Gary Stevens
4. Senator Kim Elton

Representatives

1. Rep. Jay Ramras
2. Rep. Mike Chenault
3. Rep. Kurt Olson
4. Rep. Carl Gatto
5. Rep. Paul Seaton
6. Rep. Jim Elkins

Administration

1. Dan Dickenson, Director Tax Division, Department of Revenue
2. Mark Myers, Director Oil & Gas, Department of Natural Resources (at noon)
3. Steve Porter, Deputy Commissioner, Department of Revenue

Staff

1. Mary Jackson
2. Konrad Jackson
3. Charisse Millette
4. x

MJ pick up Gatto 10:15am Friday.

MJ pick up Mark Myers at 12:15pm

MJ drop off for 5:20 flight out : Mark Myers & Carl Gatto

ALASKA STATE LEGISLATURE



Official Business

SENATE RESOURCES COMMITTEE

Senator Tom Wagoner, Chair

State Capitol, Room 427

Juneau, AK 99801-1182

Phone: (907) 465-4907 Fax: (907) 465-4779

WAGONER'S

Senator Ralph Seekins, Vice-Chair

Senator Ben Stevens

Senator Kim Elton

Senator Fred Dyson

Senator Bert Stedman

Senator Gretchen Guess

Joint Senate & House Resources Committee

Feb. 11, 2005

1:30pm: Challenger Learning Center – Kenai, Alaska

1. Call to order
2. Opening Remarks by Chairman Wagoner
3. Regulatory Presenters:
 - a. Kate Giard, Chair: Regulatory Commission of Alaska
 - b. Dan Seamount, Commissioner: Alaska Oil & Gas Conservation Commission
4. Industry Presenters:
 - a. Agrium (Bill Boycott)
 - b. ASRC Energy Services (Dan Wuthrich)
 - c. Aurora (Dave Bollins)
 - d. ConocoPhillips Alaska () *Scott Jepsen*
 - e. Marathon Oil Company (John Barnes)
 - f. Pioneer Oil Company (Gary Carlson)
 - g. Tesoro Alaska (Steve Hanson)
 - h. Udelhoven Oilfield System (James Udelhoven)
 - i. Unocal Alaska (John Zager)
5. Closing remarks by Committee Members (subject to time).
6. Adjournment.

JOINT SENATE & HOUSE RESOURCE COMMITTEE

FEBRUARY 11, 2005

KENAI

JOHN A BARNES

MARATHON OIL COMPANY

I'd like to thank you for the opportunity this afternoon to present Marathon's views regarding opportunities to enhance Cook Inlet Exploration and Development. First, despite the word oil being the second word in Marathon's corporate name, for nearly a decade our activities in the Cook Inlet have been focused on natural gas. As such, my comments will be focused accordingly.

Clearly, the topic of the day is the decline in Cook Inlet natural gas reserves and the associated impacts. At this time, based on an annual burn of around 200 bcf per year, and around 2,000 bcf (or 2 tcf) of remaining proven reserves, there is about a ten year supply of natural gas left in the Cook Inlet. In and of itself, this situation does not seem overly problematic – after all, this reserve situation is not much different from that in the Lower 48. However, the Cook Inlet market differs from other investment opportunities available to Marathon and other operators in several important ways:

1. The gas supply is isolated from the rest of North America – what we have here is all we can rely upon for our local needs.
2. The mild summer-harsh winter climate means that the large utility component of local demand has huge swings between summer and winter utility demands. This reality requires one of three solutions:
 - a. very large prolific gas reservoirs,
 - b. significant gas storage capabilities, or
 - c. pipeline connections to other sources.

Unfortunately, the large prolific reservoirs are being depleted and replaced by smaller less prolific reservoirs, no significant storage capacity currently exists and as I have already noted, there is no pipeline to other gas sources.

3. **Operating and capital costs are generally much higher in Alaska.**
4. **Permitting and regulatory hurdles can be significant in Alaska, which affects both how quickly something can be done, as well as how much it costs and the effort required.**

The net effect of these issues is that there has been a decline in Cook Inlet natural gas reserves and deliverability, and a not unexpected increase in natural gas prices as Cook Inlet proven gas reserves continue to decline.

The decline of proven reserves in the Cook Inlet was not a surprise. In 1996 one major gas producer testified before the Alaska legislature that they expected to see insufficient gas supply in the Cook Inlet to meet all needs by the mid 2000's. During the decades of oversupply, the price for Cook Inlet natural gas was extremely low by US standards, creating the opportunity for a significant industrial base using the cheap energy and feedstock. During the recent years, the supply of gas has first approached and now fallen below overall demand. As should be expected, this resulted in increased natural gas prices. On the positive side, this situation has stimulated recent exploration efforts in the Cook Inlet, which for the first time ever are focused solely on finding natural gas. This is a good start, but there is more to do.

The Cook Inlet needs a step change in natural gas exploration and development activity and I believe the State of Alaska, as well as industry, has been responding to this need for several years. I'll mention first some positive steps which have been taken, and then talk a bit about where there is clearly need for more activities by both the state and industry.

Several years ago, the State of Alaska enacted the Areawide Lease program. This has been demonstrated to be a very effective program which annually makes available lands open for leasing.

In 2003 the Legislature passed, and the Governor signed several bills directed at providing incentives for new exploration and development activities. Marathon was particularly interested in House Bill 61, an Investment Tax Credit for exploration and development of Cook Inlet

Gas Reserves. This was kicked around for several years in Juneau until the time was ripe for passage. One possible action the State could take would be to look at strengthening this incentive. It could be extended to include revitalizing old fields, returning shut-in fields to market, or perhaps even including a greater fiscal incentive.

In 2000 Enstar signed a gas sales agreement with Unocal, which was approved by the RCA, which reflected the need to pay higher prices for natural gas as an incentive for new exploration and development.

All of these actions, as well as others, have led to a recent increase in exploration and new gas discoveries in the Cook Inlet.

And recently the US DOE completed a report which identified significant potential in the Cook Inlet for additional gas through infield reserves growth, new discoveries and from coal bed methane. This same report identifies the need for significant capital expenditures to bring this gas to market and provides a high level discussion of the viability and costs associated with a spur line running to southcentral Alaska from a north slope gas line.

A few specifics from the report indicate that:

- An expenditure of \$500 million is associated with finding infield reserve growth of 1.4 tcf.
- An expenditure of \$5-6 billion is associated exploration and development of 6-8.5 tcf of potential resource.
- An expenditure of \$500 million is associated with a spur line.

These are all huge expenditures for which investors will want to closely control as many areas of risk as possible. We need to remember that one way or another, most producing companies are publicly owned. These companies are essentially stewards of value for their owners. All of us in this room make investments and desire a reasonable return – if we don't like the risk or the potential reward, we take our business elsewhere. We need to see the Cook Inlet producers in the same light, and understand their desire to generate a reasonable return for their shareholders.

What can State and local legislators and regulatory bodies do to encourage investment, which is what exploration and development

really is? They need to understand and help manage (or at least not increase) investment risk.

Oil and gas producers cannot control subsurface risk, but companies understand this and manage it.

They cannot control the risk associated with the price they get for their product, but will be willing to spend money where and when they expect to get a fair return on their investments. What this means is that Cook Inlet natural gas prices must be competitive with prices in other areas where companies can drill for and produce gas. Unless new world class natural gas discoveries are made, the era of low price natural gas in the Cook Inlet would appear to be over.

Companies work hard to control project execution risk in the areas of cost and timetables. This is a critical competency for companies which are successful. It is hoped that additional activity in the Cook Inlet will be sufficient to support an effective contract and supply base. (MOVE THIS)

The most notable risk companies now face in Alaska is regulatory and tax uncertainty. No oil and gas development speech is ever given by industry which does not identify the need for stability in these areas. I'm certain you all recognize that a good reputation takes a long time to develop, but unfortunately can be easily lost by one event.

In the Cook Inlet, Marathon is most frustrated by the delays and burdens associated with obtaining permits & regulatory approvals, which we believe greatly exceeds that which is required to best serve the public interest. At best it slows down drilling and development and increases costs, which negatively affects every Alaskan business and consumer. At worst, it kills investment and drives investment capital elsewhere, depriving Alaskans the opportunity to benefit from the State's considerable natural resources and attracting new individuals and businesses (or even retaining those we already have).

To drill a gas well onshore in the Cook Inlet can require up to 50 permits, plans, permissions and reports often involving several state, federal, and local jurisdictions. Each of these takes time. Each one costs the operator and regulatory body money to prepare, review and

approve. And each one is a potential target for litigation directed at delaying or stopping development. This is an extremely complicated problem. The permits have some basis in legislation, law and regulation. To truly impact this problem will require coordination, rationalization and trust between jurisdictions and their regulatory bodies. I'd also like to mention that Marathon respects and works well with numerous individuals and agencies. They work hard and I know so many of them are committed to doing what is right and prudent. Many agencies have also shown a great interest, an open door to discussing the issues I've raised here and we appreciate these efforts and are eager to do our part to keep lines of effective communication and cooperation open.

In addition to the permit requirements for wells and facilities, Marathon has found the permitting and regulatory time and costs associated with pipelines to be particularly burdensome. Most, if not all, new gas discoveries in the Cook Inlet will require new pipelines tied into the existing network. Marathon believes efforts to streamline the overall permitting and regulatory process for these lines will benefit not only the producers but also the end users; which includes utility customers like you and I. Recently Chairperson Giard and her fellow RCA Commissioners have begun an effort to address many of these issues. Marathon welcomes her interest and supports this effort.

GUY-
ARD

Responses to several specific questions were included in the invitation and I'll offer Marathon's views.

1. As to bringing in a jackup rig to the Cook Inlet, Marathon is concerned with the permitting and expected legal challenges associated with bringing any discovery to market. Remember, a well drilled from a jackup is just the start. Mitigating the risks associated with setting a new platform in the Cook Inlet is a formidable task.
2. Marathon has been active exploring for new gas opportunities on the Kenai National Wildlife Refuge. Although challenging, it is possible and I believe we have done a good job balancing the needs to care for the environment and develop resources.

In summary, Cook Inlet has some great attributes:

First, it is a basin with proven gas productivity and significant upside in gas resources.

Second, there is good access to lands.

Third, there is a market which needs more natural gas for both utility and industrial customers.

However, it also has considerable challenges. I strongly feel that there are two great needs:

First, the overall success of Cook Inlet gas exploration and development will be tied to the permitting and regulatory burden, including pipelines. This is the area where efforts by the State of Alaska to streamline and create more consistency in the process can have the greatest impact.

Second, the potential need to incentivize gas exploration, development and production investment activities should be considered.

Thank you.

**Regulatory Commission of Alaska
2005 Improvement Initiative**

- Goal: Identify Regulations Projects to Address in 2005**
- Goal: Increase Public Involvement in the Development of RCA Workplan**
- Goal: Address Weaknesses in RCA Regulations**

Approved by the RCA on January 26, 2005

**Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects Approved**

Item	Proposal Number	Description	Administrative Impact			Proposed Method
			Complexity	Duration	Starting Month	
<u>TELECOMMUNICATIONS</u>						
A.	1	Intercarrier Compensation	Very	2 Years	Jan-05	NOI
B.	2	New Federal IXC Provisions	Moderate	1.5 Years	Jan-05	NOI
C.	4	ETC Rules	Moderate	1.5 Years	Apr-05	NOI
D.	9	Depreciation Table	Moderate	1 Year	May-05	Advisory Group
E.	28	Affordability	Very	2 Years	Jun-05	Advisory Group
<u>ADMINISTRATIVE</u>						
F.	15	Electronic Filings	Routine	1 Year	May-05	Advisory Group
G.	30	Timeliness Standards	Routine	1 Year	Nov-05	Advisory Group
<u>PIPELINES OR GENERALLY APPLICABLE</u>						
H.	18	Alternate Dispute Resolutions	Very	1.5 Years	Mar-05	Staff Develop Regs with FERC++
I.	21	Tariff Filings	Moderate	1.5 Years	Oct-05	Staff Develop Regs++
J.	24	Discovery	Very	2 Years	Oct-05	NOI
K.	19	Stipulations	Very	1 5 Years	Mar-05	Staff Develop Regs++

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It was pointed out subsequent to the public meeting that the original plan discussed with the pipeline interests was to have these regulations prepared in a working group or other alternative method which involved stakeholders. The Chairman agrees this was the intention of the group and will bring a correction back to a public meeting in the future for a vote of the Commission

Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects and Statutory Revisions
Public Comments
Comments - Proposed Regulations

Proposal Number	Description	Utility & Pipeline Comments	
		Supporting Comments	Opposing Comments
TELECOMMUNICATIONS			
1	Intercarrier Compensation	ACS - extremely important GCI - Already Open. AT&T Alascom - useful proceeding	
2	New Federal IXC Provisions	ACS - extremely important GCI - Already Open. AT&T Alascom - rated as its most important R-docket.	
3	Customer Weighting	ACS - open, but with low priority. Not an immediate issue.	ACS - Maybe can do in R-03-03 GCI - Resolve in R-03-03
4	ETC Rules	Summit RC - High priority, need rules on designation of ETC status and on ETC standards	ACS - FCC actions pending, no docket needed GCI - Resolve on a Case By Case Basis, rules could be preempted.
5	Triennial Review Issues		ACS - more prudent to wait for FCC GCI - No regs are needed.
6	Quality of Service	RC, Summit	ACS - don't open due to limited resources GCI - Reality is regs will do little if costly to implement. AT&T Alascom - No quality of service problems, let competition address quality of service
7	Telecommunications Act - Rewrite		ACS - Don't know yet where headed, too early, suggests maybe a workshop. GCI - R Docket is too cumbersome a process to develop responses to legislative inquiries.

Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects and Statutory Revisions
Public Comments
Comments - Proposed Regulations

Proposal Number	Description	Utility & Pipeline Comments	
		Supporting Comments	Opposing Comments
TELECOMMUNICATIONS			
8	Bundling - Outstanding issues		ACS - Bundling only recently implemented, issues for consideration are not an immediate concern AT&T Alascom - would give bundling issues a low priority GCI - These rules are not critical.
9	Depreciation Table	ACS (mid priority), RC, Summit, GCI (with suggestion)	GCI - Adopt the FCC table in R-03-03
10	Carrier of Last Resort	ACS - should consider shared COLR issues, use separate LEC and IXC proceedings, assigns a mid priority	AT&T Alascom - no need in IXC market; issue was adequately addressed in R-03-03. GCI - Case by case basis. Regs will be easier to adopt after real-world experience.
11	Housekeeping Changes to IXC Registration	GCI - Address after Staff produces proposed rules.	
12	Registration of Payphones; Annual Report Requirements for Private and Public Interest Payphones	GCI - If the Commission is receiving many applications, address after Staff produce proposed rules.	
13	Update/ standardizing of filing forms	GCI - Address after Staff produces proposed rules.	ACS
14	800 Query Policies	AT&T Alascom - 800 Query policies are an area of confusion and difficulty	ACS - better to resolve pricing issues through the tariff process, R Docket may not be necessary GCI - Resolve in adjudicatory dockets.

Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects and Statutory Revisions
Public Comments
Comments - Proposed Regulations

Proposal

Number Description

Utility & Pipeline Comments

Supporting Comments

Opposing Comments

TELECOMMUNICATIONS

ADMINISTRATIVE

15	Electronic Filings	<p>ACS (mid priority), AT&T Alascom Chugach - Supports but need to better define cost. Appears low. Tesoro/Agrium support Conoco (North Slope) Lower priority Enstar supports GCI - Necessary when Commission is able to accept electronic filings.</p>
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16	Practices and Procedures	<p>GCI - Address after Staff produces proposed rules.</p> <p>Tesoro/Agrium support, limited scope Chugach discovery comments also focused on practice and procedure. Enstar supports, limited scope</p>	ACS
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17	Housekeeping - PAS	<p>GCI - Address after Staff produces proposed rules.</p>	ACS - not critical project
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PIPELINES OR GENERALLY APPLICABLE

18	Tariff Filings	<p>Tesoro/Agrium support, prefiled testimony</p>	<p>ACS - of little value to ACS, but maybe to others BP - Believes statutory changes are nec. GCI- Requiring prefiled testimony will be highly contentious.</p>
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19	Stipulations	<p>BP - Believes statutory changes are nec. Chugach - Supports proposal to identify standards.</p>	<p>ACS - not critical project GCI - Case by case basis. Tesoro/Agrium - Best left to adjudication Enstar - agrees with Tesoro/Agrium</p>
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20	DR&R	<p>BP - Believes statutory changes are nec.</p>	<p>Tesoro/Agrium - Best left to adjudication</p>
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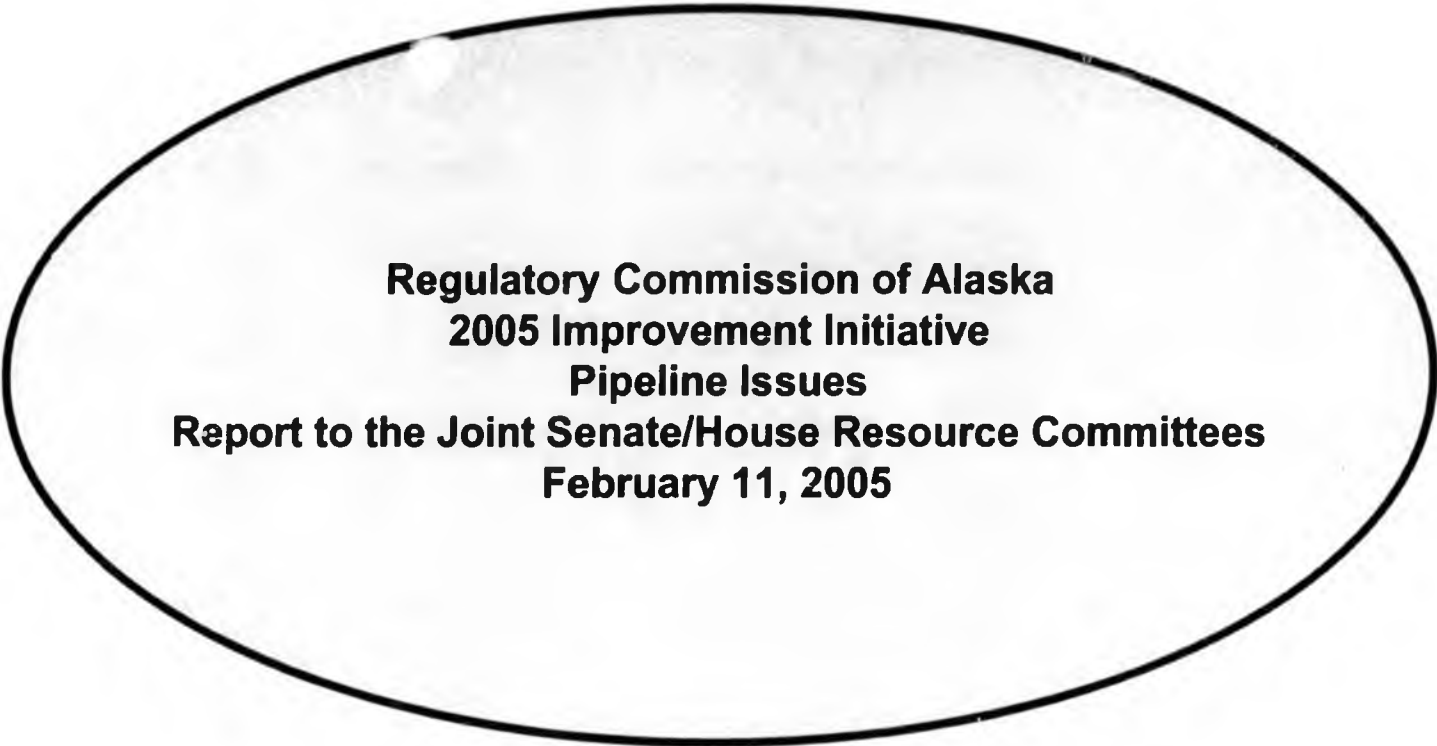
Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects and Statutory Revisions
Public Comments
Comments - Proposed Regulations

Proposal Number	Description	Utility & Pipeline Comments	
		Supporting Comments	Opposing Comments
TELECOMMUNICATIONS			
21	Discovery	ACS - historical difficulties with discovery, mid priority project BP - Highest Priority (one of three) Tesoro/Agrium support Conoco (North Slope) Chugach Supports and has specific recommendations for commission consideration	GCI - Case by Case Basis.
22	Pipeline Certification		Tesoro/Agrium - no clear need
23	Transfers	GCI - Appropriate but not critical. Conoco (North Slope) - Lower priority Enstar supports	ACS - not critical project Tesoro/Agrium - no clear need
24	Alternate Dispute Resolutions	BP - Highest Priority (one of two) Tesoro/Agrium supports, but hesitant, must be done properly Conoco (North Slope) support Enstar agrees with Tesoro/Agrium	ACS - not critical project
25	Open Season	Conoco (Cook inlet) supports Chugach supports and encourages Commission to work with Utilities to understand natural gas needs.	Tesoro/Agrium - Best left to adjudication Enstar - agrees with Tesoro/Agrium
26	Instate Gas use		Tesoro/Agrium - No need for R-docket Enstar - high priority issue, but not for R docket
ITEMS ADDED DURING PUBLIC MEETING			
27	Access Charge Reform 2	AT&T Alascom - First phase of access charge reform was beneficial, encouraging investment and reducing arbitrage. Given time for review, would be good to consider phase 2 reforms. In R-01-01 all agreed to move to phase 2. RC - Supports review	ACS - recent reform was only just completed, learn from implementation before attempting new reform, Intercarrier Compensation reform is occurring, further considering access charge reform now is not a good use of resources.

**Regulatory Commission of Alaska
Public Meeting - January 26, 2005
Regulations Projects and Statutory Revisions
Public Comments
Comments - Proposed Regulations**

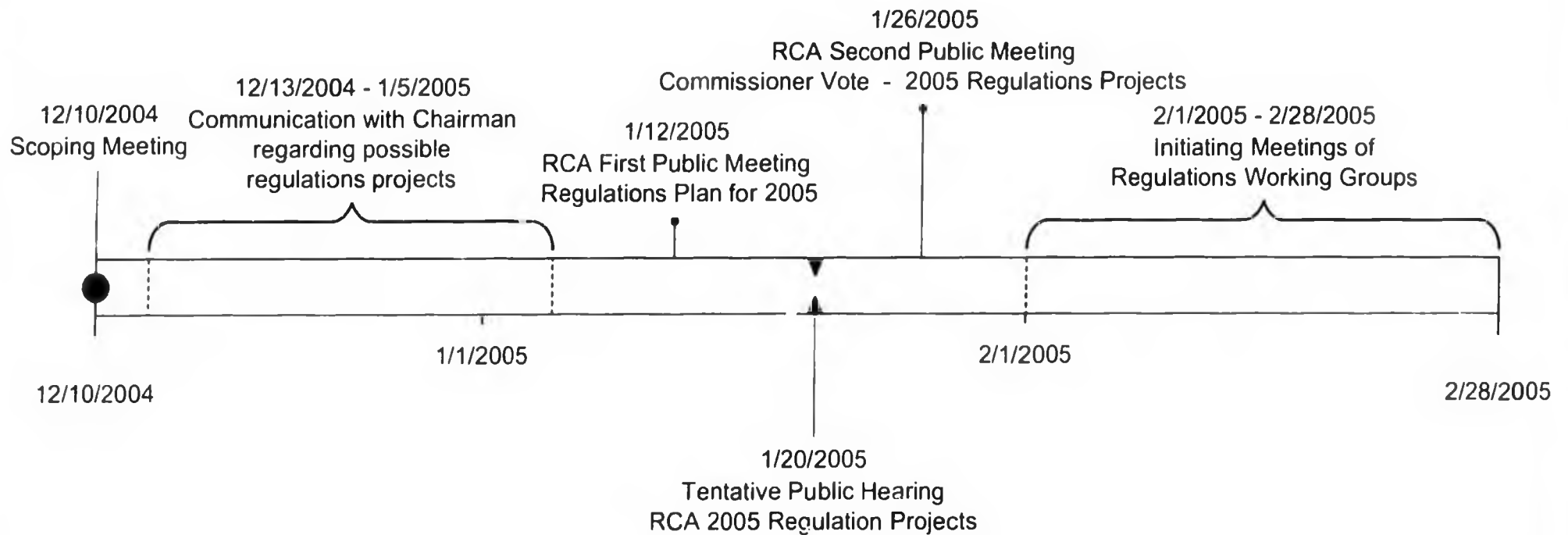
Proposal Number	Description	Utility & Pipeline Comments	
		Supporting Comments	Opposing Comments
TELECOMMUNICATIONS			
28	Affordability	ACS (mid priority), RC (high priority). RC would limit to telco issue.	
29	Exparte/ Pre application discussions	ACS - suggests the Commission review its exparte rules; specifically mentions meetings on adjudicatory matters before a docket is opened, pre application discussions, and discussions during rulemakings, sees as mid priority	
30	Timeliness Standards	ACS - believes notice of inquiry is needed, refers to interpretation of timeliness standards in the case involving Carr Gottstein. Sees as high priority.	
31	Rural Regulatory Parity	RC - High priority, need to address due to pending competition in rural areas without adequate rules	
Harbour	Pipeline Connection Forms		
Harbour	Affiliate relationships		
Harbour	Power/gas supply agreements		
Harbour	F-W-A standards - financial info		
Read in	Utilize JPO	Conoco Phillips - Written Comments	
Read in	Preapplication meetings	Conoco Phillips - Written Comments	
Read in	Flow lines	Joint Pipeline Office Written Comments	

Note: ATA indicated its rural interests were represented by the Rural Coalition



**Regulatory Commission of Alaska
2005 Improvement Initiative
Pipeline Issues
Report to the Joint Senate/House Resource Committees
February 11, 2005**

▶ RCA 2005 Improvement Initiative 2005 Regulations Projects Planning and Preparation



Dave Walters
Unocal Alaska

Meg Yaege
Colleen Mukavitz
ConocoPhillips
Transportation

Tony Izzo, Enstar
Natural Gas

Jane Petry,
ExxonMobil
Pipeline

Steve Haagenson,
Golden Valley (via
teleconference)

Kent Hampton,
Kenai Kachemak
Pipeline, LLC

Jim Senn, Agrium
US, Inc.

Rodney Cason
Tesoro Alaska
Pipeline Company

Leonard Gurule,
Forest Oil
Corporation

Jerry Brossia
Joint Pipeline Office

Regulatory Commission of Alaska
2005 Improvement Initiative
Scoping Meeting
Pipeline Issues
December 10, 2004

Bill Corbus &
Scott Porter
Department of
Revenue

John Norman,
Alaska Oil & Gas
Conservation
Commission

Phil Reeves, Alaska
Attorney General's
Office

Judy Brady, Alaska
Oil & Gas
Association

Jan Wilson, RCA

Blythe Marston,
RCA

Dawn Bishop, RCA

Jim Strandberg,
RCA

Kate Giard, RCA

Shawn Brown
Kenai Pipeline
Company

Al Bolea, BP
Pipelines Alaska,
Inc.

John Barnes,
Marathon Oil
Company

Mark Hanley,
Anadarko
Petroleum

Chuck Coulson, BP
Exploration Alaska,
Inc.

Rob Knapp, Koch
Alaska Pipeline
Company

Doug Chapaodos,
Petro Star, Inc.

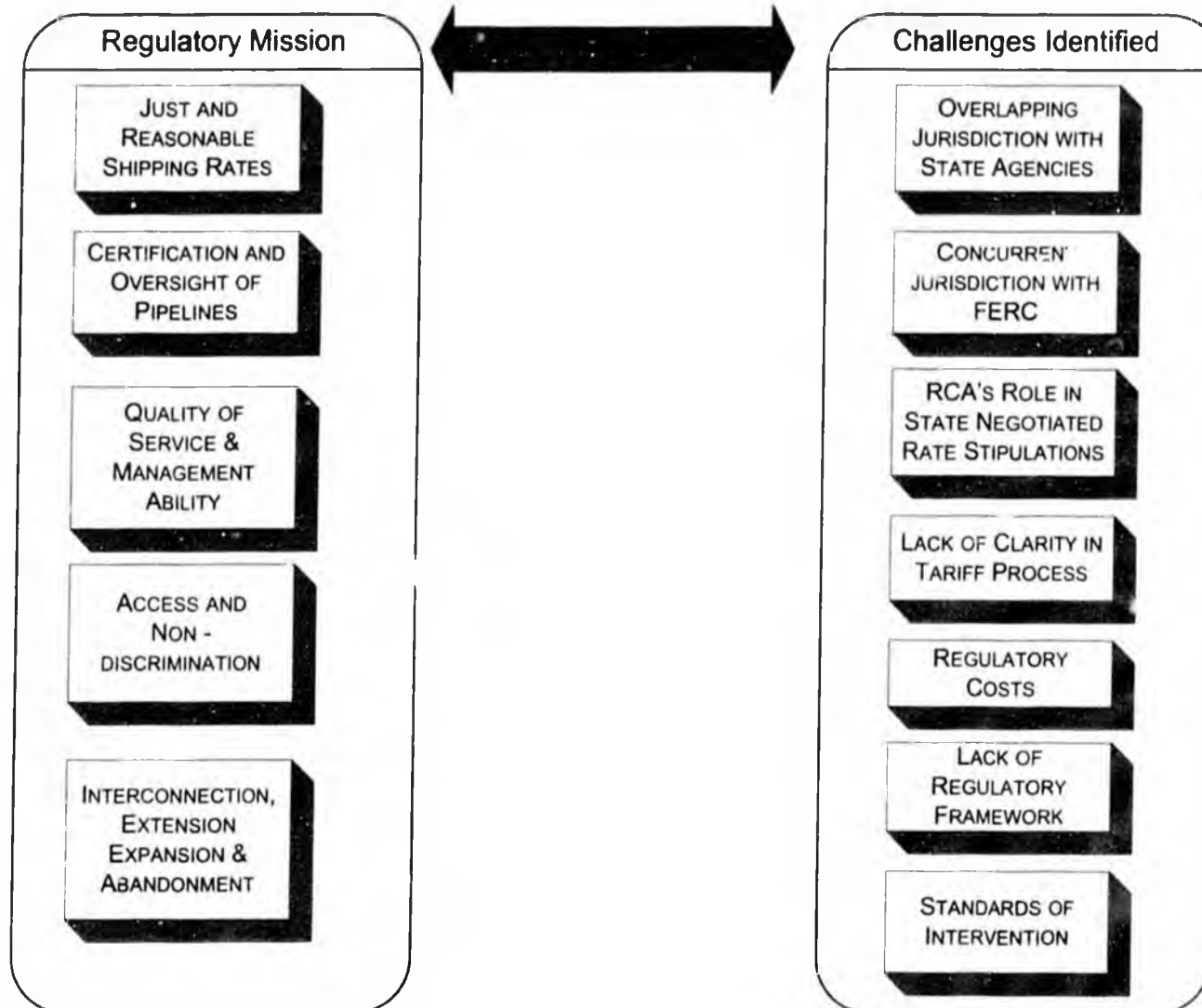
David Boelens,
Aurora Gas, LLC.

Lanston Chinn,
Kuukpik
Transportation
Company, LLC

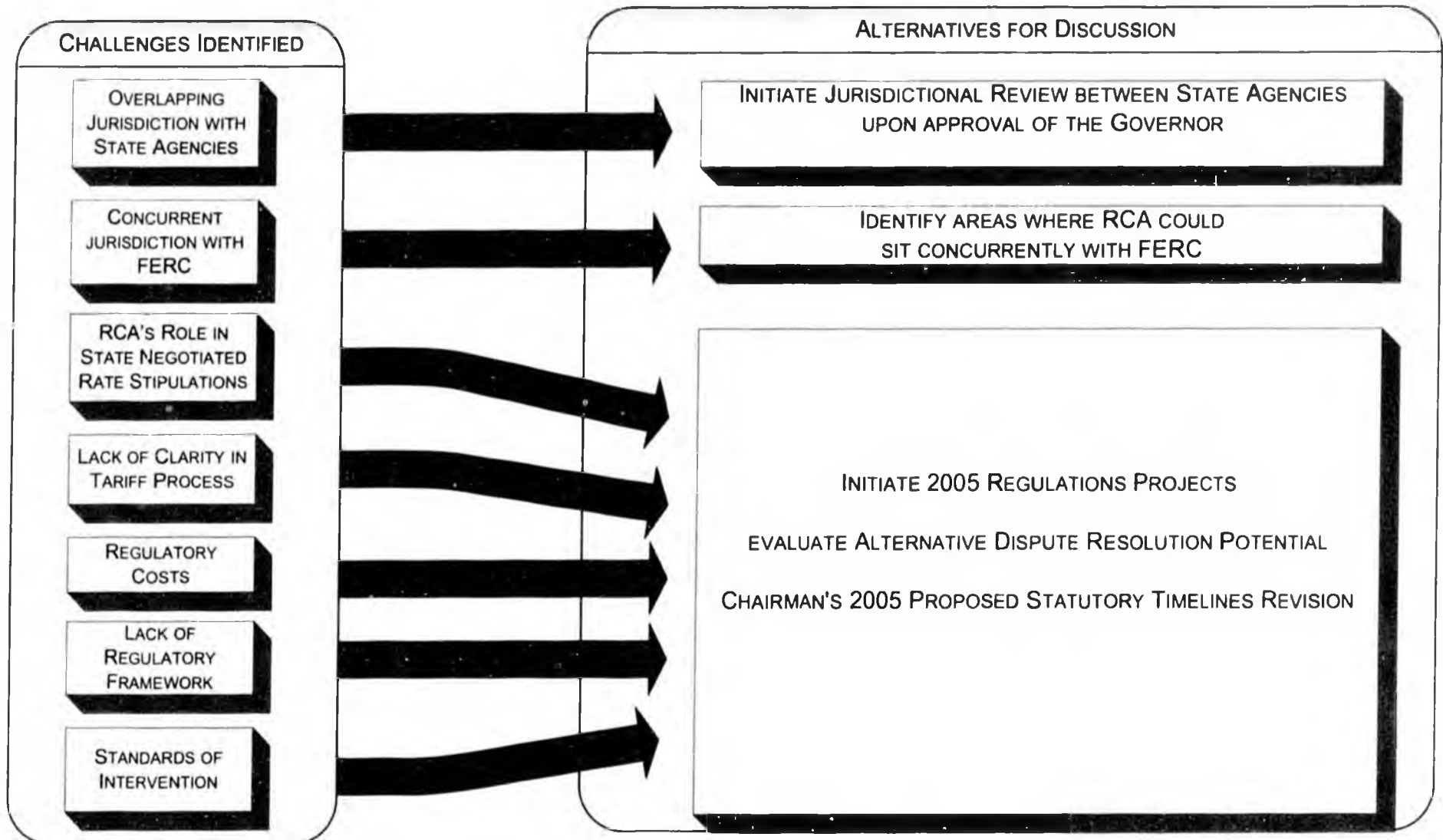
Marty Rutherford,
Department of
Natural Resources

RCA 2005 Improvement Initiative

Mission versus Challenges



RCA 2005 Improvement Initiative Challenges & Alternatives



RCA 2005 Improvement Initiative

Next Steps

Jurisdictional Overlap

INITIATE JURISDICTIONAL REVIEW BETWEEN STATE AGENCIES
UPON APPROVAL OF THE GOVERNOR

OBTAIN APPROVAL FROM GOVERNOR'S OFFICE FOR
STATE AGENCY PARTICIPATION

POSSIBLE AGENCY PARTICIPANTS
RCA
DNR
REVENUE
JOINT PIPELINE OFFICE
ATTORNEY GENERAL

INDUSTRY PARTNERS TO PROVIDE WHITE PAPER ON
SPECIFIC AREAS OF OVERLAP FOR ANALYSIS

AGENCIES CONTRIBUTE RESOURCES TO EVALUATE
OVERLAP



**RCA 2005 Improvement Initiative
Next Steps
Concurrent Jurisdiction with FERC**

RCA STAFF TO IDENTIFY OPPORTUNITIES

RCA MEETING WITH FERC IN JANUARY/FEBRUARY IN DC
TO SCOPE VARIOUS PROJECTS

JOINT FERC/RCA LETTER TO GOVERNOR

CHAIRMAN'S REPORT TO OVERSIGHT COMMITTEE IN
MARCH



→ **RCA 2005 Improvement Initiative**
Next Steps
2005 Regulations Projects

TARIFF RULES FOR PIPELINES

ALTERNATIVE DISPUTE RESOLUTION

DISCOVERY RULES GOVERNING PIPELINE CASES

STIPULATIONS

DR&R (CURRENTLY OPEN DOCKET)

FORM WORKING COMMITTEES, TIMELINES AND
GOVERNANCE

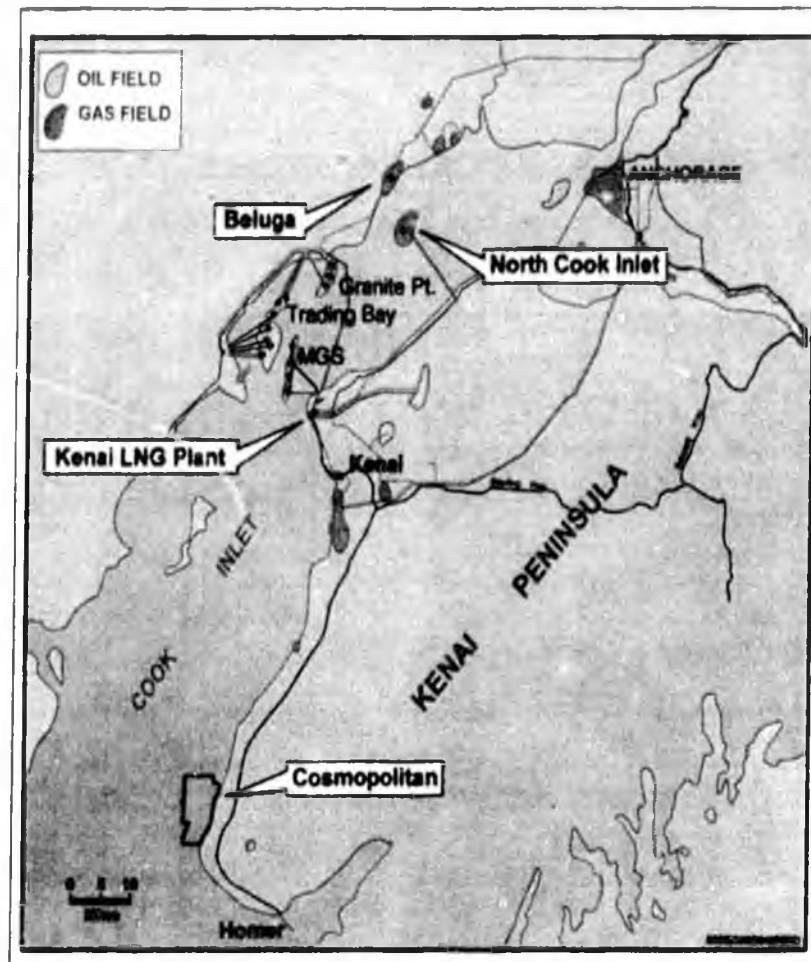
ConocoPhillips Testimony Joint Senate/House Resource Committee

February 11, 2005

Overview



- ConocoPhillips has been a part of the Cook Inlet community since the early '60's
- Cook Inlet Assets
 - Beluga River Field - 1968
 - Operator
 - 33% Working Interest
 - North Cook Inlet Unit - 1969
 - Operator
 - 100% Working Interest
 - Kenai LNG Plant - 1969
 - Operator
 - 70% Working Interest
 - Cosmopolitan (Exploration play)
 - Operator
 - 70% WI
- ConocoPhillips Alaska Focus
 - ANS gas
 - NS exploration
 - Development potential in existing assets

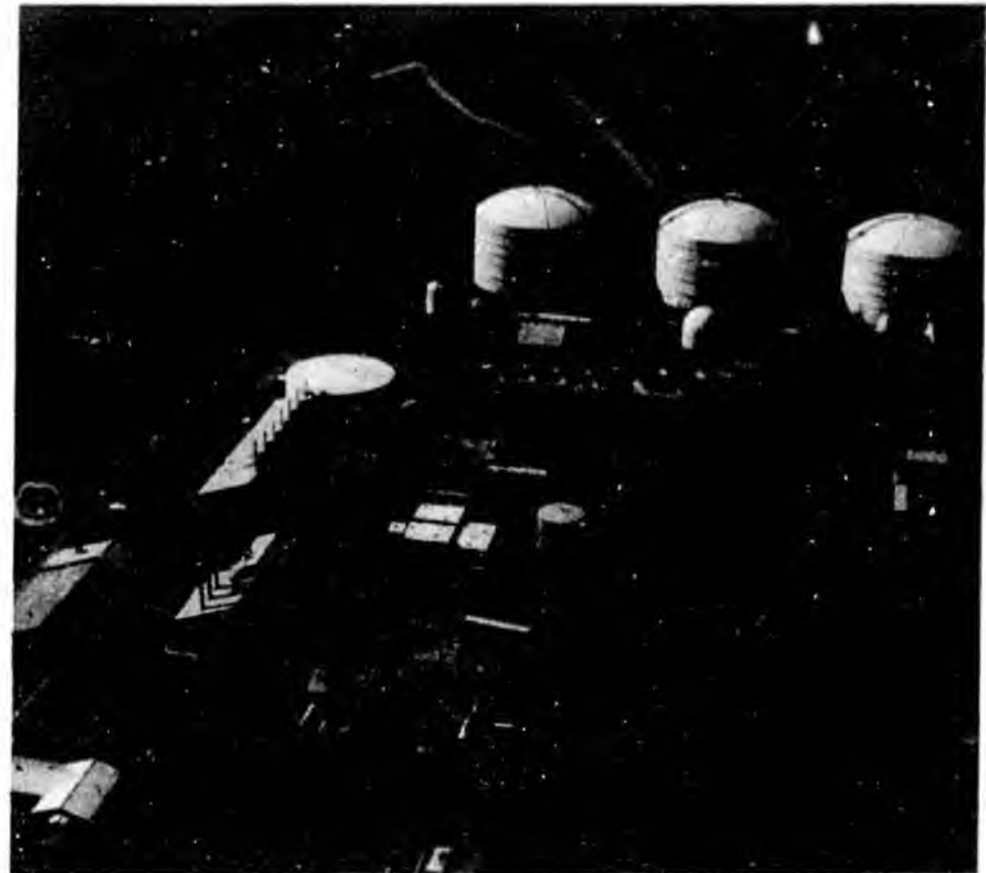


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- **\$54MM in Financial Contributions**
 - \$16MM royalties
 - \$11MM severance taxes
 - \$2MM property taxes (Kenai Borough)
 - \$8MM in wages
 - \$17MM Cook Inlet area supplier spend
 - \$220,000 in direct contributions to Kenai Peninsula non-profits

- **Cook Inlet operations employs ~90 local residents**



Cook Inlet Business Environment



- Advantages
 - Stable, talented workforce
 - Supportive government and local population
 - Significant infrastructure
 - Resource rich

- Recommendations
 - Stable state-wide tax environment
 - Non-discretionary tax credits for exploration and new investments (including existing fields)
 - Increased access to lands and efficient permitting processes



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ASRC Energy Services
a subsidiary of Arctic Slope Regional Corporation

Alaska State Legislature Senate Resources Committee

Cook Inlet Basin Oil & Gas Forum

February 11, 2005

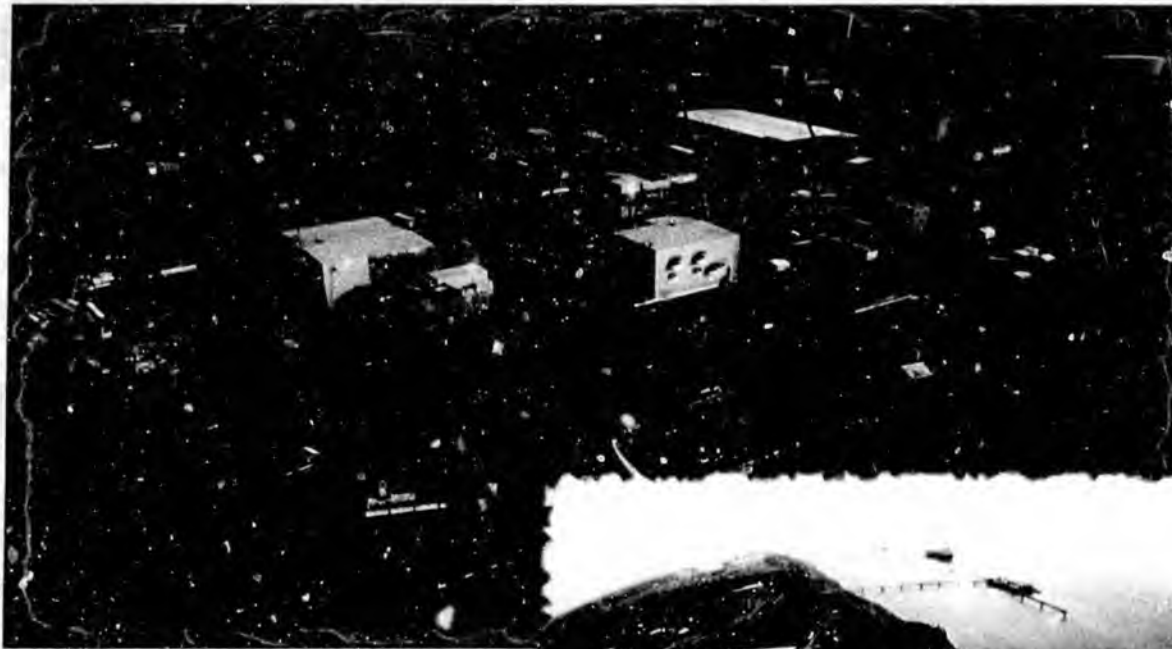
Nikiski, AK Fabrication Facility



CAPACITIES:

- Largest deep-water fab dock face in Alaska
- 10,000 ton dock face capacity + beaching
- Live-load + Dead-load capabilities
- 25,000 tons/yr module capacity
- 26,000 sq. ft. shop (environmentally controlled)
- 31 acres; 8 acres lighted dock/lay-down
- pipe, steel fabrication
- 2100 LF Dock-face

Alpine Module Assembly Project



- 18 Modules
- 5,000 tons total
- 9 sealift modules at Nikiski
- 1,100 tons largest
- 14 month duration



PHOTO BY: ROB STAPLETON

Assembly Site Schedule



Alpine Project:

- 3/98 Site preparation began - \$1.4mm upgrades
- 6/98 Module construction and assembly began
- 7/99 Modules shipped to North Slope
- 11/00 Oil flowing at Alpine

Local Community Impact



- 759,000 man-hours expended by local labor and staff
- \$23.2mm+ wages paid to local craft
- 340 craft personnel
- 46 staff personnel
- \$1.2 mm spent on subcontracts to:
 - Atigun, Inc.
 - R & K Industrial
 - Metal Magic
 - Guardian Security
 - Laidlaw Transit
 - Dunkin & Bush
 - Others

Community Impact (cont.)



- \$7.5mm spent with local vendors on:
 - Consumables
 - Commodities
 - Tools
 - Equipment rentals
 - Services
 - Materials
- Community college worked to train craft for the project (21 welders)

Existing Fields Are Showing Their Age

Opportunities to attract new projects by:

- Streamlining permitting process
- Providing tax and other incentives to attract new exploration and development
- Supporting an exploration rig for offshore development
- Support the 2006 Alaska Cook Inlet OCS lease sale.

Thank You



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DALE BAGLEY
MAYOR

Cook Inlet Oil & Gas 2004 Annual Report

Bill Popp, Oil and Gas Liaison

January 21st, 2005

The Kenai Peninsula Borough and the Cook Inlet Basin, as Alaska's first oil and gas province, continues to play a vital role in the economy of Alaska. This report will address a number of important issues related to oil and gas reserves, future production and related issues of interest to the Kenai Peninsula Borough.

Highlights of this report include:

- Net proven natural gas reserves within the Cook Inlet Basin have increased for the first time since 1997. (Page 4)
- Forecasted Cook Inlet natural gas annual production levels will not drop below 200 billion cubic feet until 2007. (Page 5)
- U.S. Department of Energy study estimates significant undiscovered reserves of conventional natural gas in excess of 13 trillion cubic feet yet to be discovered in the Cook Inlet Basin. (Page 6)
- The Prevailing Value of Cook Inlet natural gas continues to trend upwards and is approaching an annual average in excess of \$3.00+ per thousand cubic feet of natural gas. (Page 6)
- Cook Inlet natural gas pricing will continue to trend upwards in 2005. (Page 7)
- Natural gas exploration will continue at strong levels in the onshore regions of Cook Inlet in 2005. (Page 8)
- The deliverability of natural gas within the Cook Inlet Basin may become an even more significant issue for both industrial and utility users in the next winter season unless storage capacity is established within the Cook Inlet Basin. (Page 10)
- Several North Slope natural gas pipeline projects, none of which have yet achieved clear economic viability, will continue to develop in 2005. (Page 11)

- Federal Outer Continental Shelf (OCS) lease sale 199 is on schedule for May, 2006 and offers significant potential oil and natural gas reserves opportunities. (Page 14)
- Proposed Bristol Bay oil & gas leasing could offer opportunities to the support industry companies of the Kenai Peninsula Borough. (Page 15)
- Net proven oil reserves within the Cook Inlet Basin were significantly downgraded in 2004 and are forecasted to be depleted by the end of 2016. (Page 16)
- New State and Federal incentives will be needed to stimulate new oil exploration efforts within the Cook Inlet Basin if new proven oil reserves are to be discovered. (Page 18)
- Crude oil related exploration efforts will be at modest to minimal levels in 2005. (Page 19)
- Dismantling, Removal & Restoration (DR&R) standards for Cook Inlet platforms will become a major topic in the next few years related to taxable property values within the Kenai Peninsula Borough. (Page 20)
- The Cook Inlet National Pollutant Discharge Elimination System (NPDES) oil and gas general permit renewal process could impact the economics of Cook Inlet offshore platforms. (Page 21)
- The Pebble Gold-Copper project in Iliamna, if developed, will offer opportunities to the Kenai Peninsula Borough for several hundred jobs and general infrastructure and economic development. (Page 21)
- Workforce demands exceeding several thousand skilled workers in the oil and gas related industries could develop in Alaska during the next 4 to 8 years. (Page 23)

Natural Gas

Cook Inlet natural gas reserves have been an issue in recent years due to declines in net proven reserves and problems related to the deliverability of natural gas to utility and industrial end users. This section will examine these two topics and the future outlook for solutions.

Natural Gas Reserves

The following chart describes Cook Inlet natural gas proven reserves since the most recent peak proven reserves year of 1997. Reserves replacement data are calculated inclusive of annual natural gas consumption and net proven reserves.

Estimated Cook Inlet Basin Reserves, Consumption and Reserves Replacement 1997 to 2004				
Year	Proven Reserves ¹ (Billion Cubic Feet)	Total Annual Production ² (Billion Cubic Feet)	Net Proven Reserve Increase/Decrease (Billion Cubic Feet)	Reserves Replacement (Billion Cubic Feet)
1997	3,281	215	+439	+653
1998	3,066	215	-215	0
1999	2,843	213	-223	-10
2000	2,564	216	-279	-63
2001	2,460	222	-104	+118
2002	2,240	210	-220	-10
2003	2,031	208	-209	-1
2004	2,088	219 ³	+57	+276

Based on this data, Cook Inlet natural gas proven reserves have grown for the first time in seven years by 57 billion cubic feet (bcf). Of more significance is the increase in reserves replacement in 2004 that generated 276 bcf of natural gas that offset 2004 total annual consumption while contributing to a net gain of proven reserves in the Cook Inlet Basin.

Significant declines in proven reserve estimates in the offshore McArthur River and North Cook Inlet units and the onshore Swanson River Unit totaled 124.3 bcf in lower reserves were offset by new exploration efforts in the Ninilchik, Deep Creek & Beluga Units and in-field rework efforts in the Kenai Unit that generated 219.6 bcf of new proven reserves. The balance of increased natural gas reserves replacement totaling 180.7 bcf in 2004 was the result of exploration and in-field rework in several smaller units located throughout the Cook Inlet Basin.

These new proven natural gas reserves estimates have generated a revised production forecast⁴ that is represented in the following graph.

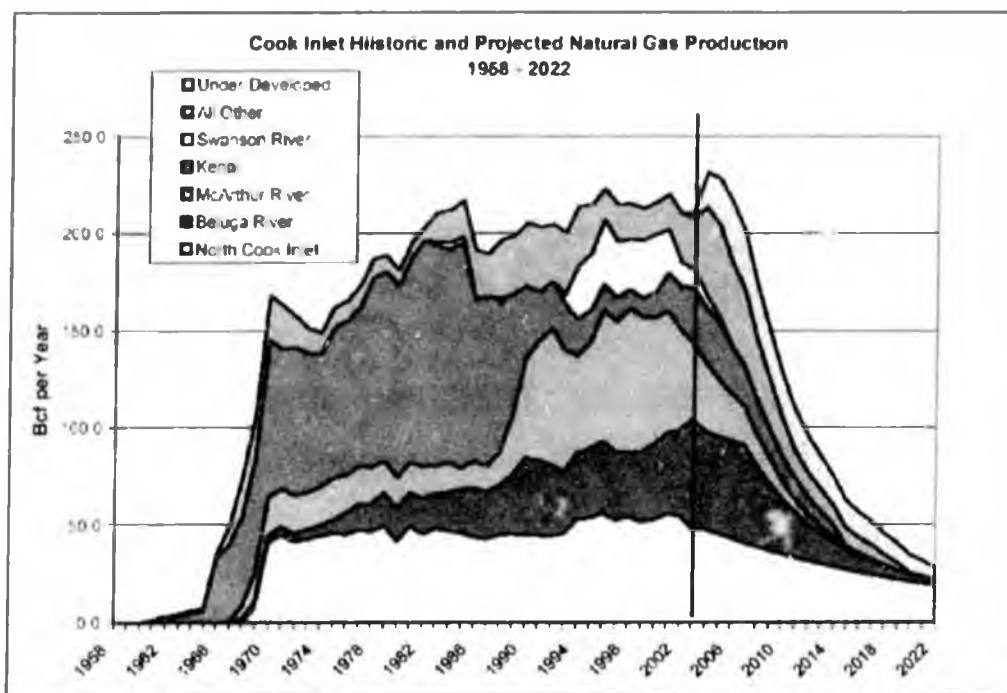
¹ State of AK, Department of Natural Resources, Division of Oil & Gas Annual Reports 1996 through 2004

² State of AK, Department of Natural Resources, Division of Oil & Gas Annual Reports 1996 through 2004

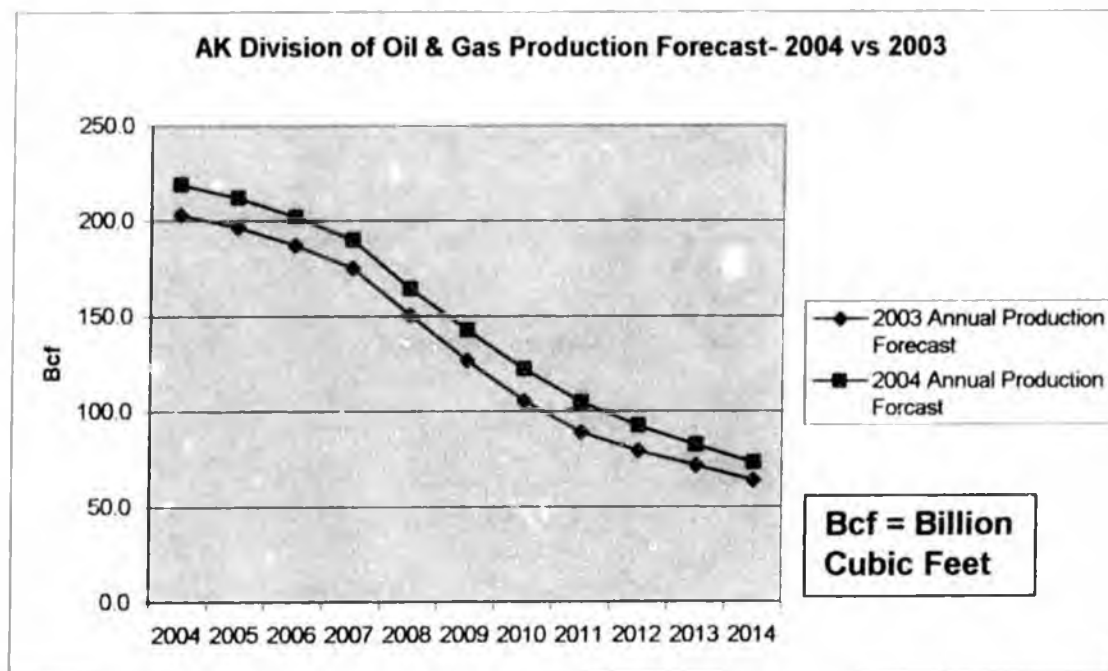
³ State of AK, Department of Natural Resources, Division of Oil & Gas 2004 Annual Report, Page 4-25 Forecast of Natural Gas Production in 2004

⁴ State of AK, Department of Natural Resources, Division of Oil & Gas 2004 Annual Report, Figure IV.6

Cook Inlet (Billion Cubic Feet per Year)



The significance of this updated production projection is that the previously forecasted annual production decline below the 200 bcf threshold, last projected for 2005, has now been pushed back to the year 2007. Additionally, the ten-year forecast now projects an additional total production of 157 bcf of natural gas over the previous ten year forecast in the 2003 Annual Report.⁵ This revised ten-year forecast is represented in the following graph.



⁵ State of AK, Department of Natural Resources, Division of Oil & Gas 2004 Annual Report, page 4-25

This new reserves replacement effort by industry has been driven by increased Cook Inlet market prices for natural gas that have been on the rise in recent years. This upward pricing pressure is discussed later in this report.

Proven natural gas reserves replacement was a subject of intense public and industry discussion in 2004. Of most significance to this dialog was the release of the U.S. Department of Energy (DOE) study⁶ of potential reserves within the Cook Inlet Basin. This study, based on a statistical analysis of publicly available geological and industry data, estimates that there are potentially 13 to 17 trillion cubic feet (tcf) of natural gas reserves yet to be discovered within the Cook Inlet Basin.

However, costs to discover and develop these potential reserves are substantial. The DOE study estimates that efforts to find and develop 50%, or 8 tcf of these potential reserves would cost a minimum of \$5.0 billion if the reserves were mainly located onshore. In simplistic terms, at the FY2004 Cook Inlet average annual Prevailing Value of \$2.82 per thousand cubic feet (mcf) of natural gas, this 8.0 tcf of natural gas would have a gross value of \$22.56 billion.

In evaluating the likelihood of whether reserves of this size could still exist within the Cook Inlet Basin, the study noted that 95% of all Cook Inlet's current proven natural gas reserves were discovered before 1970. The study also noted that there was no natural gas focused exploration in the Cook Inlet Basin until the late 1990's. All previous discoveries were, in effect, accidental and coincidental to exploration for structurally trapped oil. And finally, there is a significant absence of medium to large gas fields when viewed from geologic expectations, based on similar geological structures elsewhere. With significant new exploration, which would require substantial financial investments, there is a high likelihood of discovering significant new natural gas reserves within the Cook Inlet Basin.

Natural Gas Pricing

Delivered natural gas prices to all consumers in Alaska continued to rise during the most recently completed reporting period ending in 2003. According to the U.S. Department of Energy,⁷ the cost of delivered natural gas to Alaska consumers were as follows:

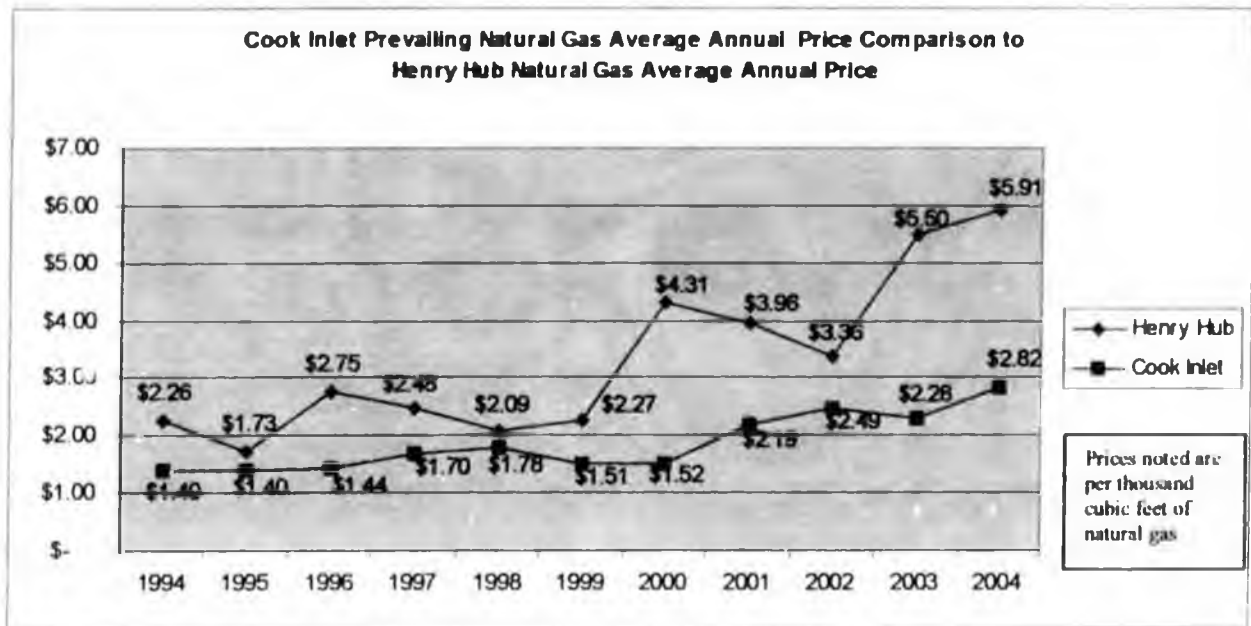
U.S. Department of Energy Costs of Delivered Natural Gas to Consumers		
Alaska Consumer	Price per mcf	% increase since 1999
Residential	\$4.39/mcf	21%
Commercial	\$3.58/mcf	64%
Industrial	\$1.75/mcf	40%
Electric Power	\$2.33/mcf	47%

This delivered cost analysis is an average of delivered natural gas prices from across Alaska, including the North Slope, and are not necessarily specific to any one company or region. However, these statewide cost trends are indicative of recent pricing trends within the Cook Inlet Basin. Based on the following information, this upward pricing trend will continue in 2005.

⁶ U.S. Department of Energy, "South-Central Alaska Natural Gas Study," June, 2004

⁷ U.S. Department of Energy, Energy Information Administration, "Natural Gas Annual 2003," December, 2004

Since 1999, the annual average prevailing value of Cook Inlet natural gas⁸ increased by 87%, from \$1.52 to \$2.83 per mcf. Similarly, natural gas prices in the broader U.S. markets have also seen dramatic increases. Using the Henry Hub commodity price⁹ as a comparative indicator, Lower 48 natural gas prices have increased 160%, from \$2.27 to \$5.91. These two price indicators are represented in the following ten-year history graph:



The comparison of Cook Inlet natural gas prices to Henry Hub natural gas prices is particularly germane to the topic of Cook Inlet natural gas prices.

In late 2001, the Regulatory Commission of Alaska (RCA) approved a Gas Sales Agreement¹⁰ (GSA) between Unocal & Enstar that is tied to a trailing three year average of daily Henry Hub natural gas Futures prices, with a floor price of \$2.75 per mcf of natural gas. The RCA, reasoning that Cook Inlet natural gas reserves were in decline and that current prices for Cook Inlet natural gas were not competitive in the context of the larger global exploration markets, approved this agreement with the intent to spur new natural gas exploration and development within the Cook Inlet Basin. This premise seems to be initially justified, based on the latest Cook Inlet natural gas reserves estimates described earlier in this report.

Based on the new pricing structure, it is likely that the average annual Prevailing Value of Cook Inlet natural gas will exceed \$3.00 per mcf in 2005. This upward pricing trend will likely continue through the end of 2005 and is directly affected by lower 48 natural gas

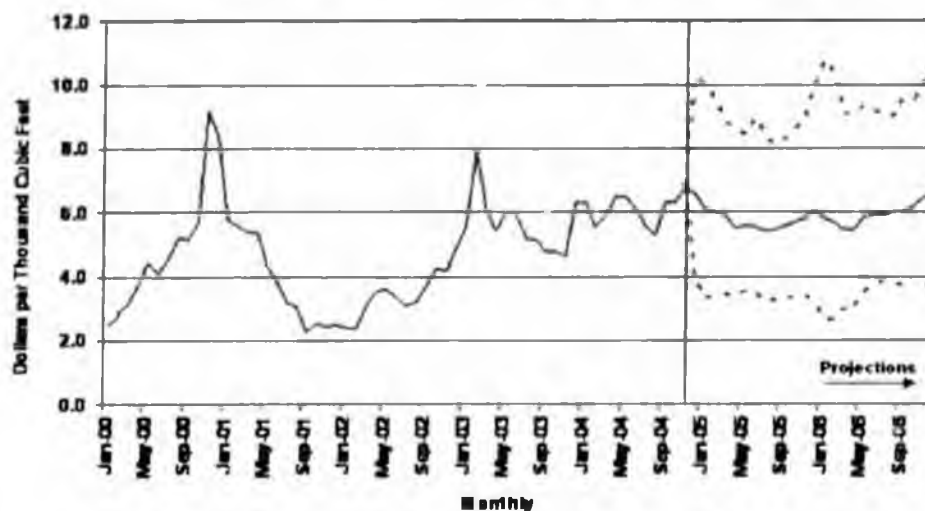
⁸ State of Alaska, Department of Revenue, Cook Inlet Natural Gas Prevailing Value, www.tax.state.ak.us. "As provided under 15 AAC 55.173(b) for gas delivered in the Cook Inlet area, the Department will publish on the 15th of each calendar quarter, the prevailing value for that quarter. This prevailing value is the weighted average price of significant sales of gas to publicly regulated utilities in Cook Inlet."

⁹ U.S. Federal Reserve Bank of St. Louis, Economic Research Division: Wall Street Journal/Haver Analytics

¹⁰ Regulatory Commission of Alaska, Order #U-01-7(8) approving GSA between Unocal & Enstar/Semco Energy

prices¹¹ described in the following chart¹² that provides an 18-month projection for national trends in natural gas pricing:

**Figure 9. U.S. Natural Gas Spot Prices
(Base Case and 95% Confidence Interval*)**



*The confidence intervals show ± 2 standard errors based on the properties of the model. The ranges do not include the effects of major supply disruptions.

Source: History: Natural Gas Week; Projections: Short-Term Energy Outlook, January 2005



Natural Gas Exploration Outlook for 2005

Several companies have planned exploration efforts in the Cook Inlet Basin, while several are still on the sidelines awaiting specific announcements, if any, for new exploration efforts in the Cook Inlet Basin. Here is a recap of those companies:

- **Unocal** continues to focus on the lower Kenai Peninsula in the Ninilchik and Anchor Point areas. Several exploration and development wells are planned for the third quarter of 2005 in addition to a comprehensive seismic study scheduled to cover all lease tracts in and near the Deep Creek, Ninilchik and Nikolaevsk Units. Unocal has completed the multi-million dollar extension of the KKPL pipeline in 2004 through Ninilchik and out to the Happy Valley Gas Field and will examine needs for collector lines to connect new producing wells in the area to the KKPL. Offshore efforts are focused on maintenance for 2005.
- **Marathon Oil Company** continues an aggressive schedule of exploration and development work in 2005 after an equally strong year of effort in 2004. Work continues in the Ninilchik Unit to fully explore and develop this significant coastal field. Ongoing infield rework efforts will continue at many of Marathon's existing fields such as the Kenai Unit. Seismic work in Marathon's newly acquired acreage along the Kenai River corridor between Soldotna and the eastern boundaries of the Sterling area will likely begin this year. In addition, it appears work will finally begin

¹¹ U.S. Department of Energy, Energy Information Administration "Annual Energy Outlook 2005 Overview"

¹² U.S. Department of Energy, Energy Information Administration "Short-Term Energy Outlook 2005," January, 2005

this year on the East Swanson prospect in the Kenai National Wildlife Refuge. Marathon is the lead on this joint venture with Unocal and Cook Inlet Region, Inc. Preliminary results from the Kasilof Unit directional drilling project may also be released in 2005. Finally, Marathon reactivated the Spark platform in late 2004 for natural gas production.

- **Aurora Gas LLC** is the most active new player in Cook Inlet in recent years with very aggressive and successful history of re-entry projects that develop previously abandoned exploration wells looking for natural gas. Aurora is continuing that effort in 2005, mainly on the Westside of Cook Inlet. However, Aurora is expanding its operations in 2005 to venture into exploration drilling for oil which will be discussed later in this report. Aurora estimates that new Westside prospects could contain 400 bcf to 1.0 trillion cubic feet of gas.¹³
- **ConocoPhillips** has no announced plans for new exploration or development activities in 2005. Operations at the North Cook Inlet Unit will continue on a status quo basis. Natural gas produced at the Tyonek platform will continue to serve the LNG plant in Nikiski.
- **Forest Oil Company**, which has previously exclusively targeted oil in Cook Inlet, has announced several efforts to explore for and develop onshore natural gas in 2005. These efforts will be focused on the Westside of Cook Inlet and on two exploration licenses in the Susitna Basin that encompass over 850,000 acres.
- **Cook Inlet Region Incorporate (CIRI)** has substantial sub-surface oil & gas rights in the Cook Inlet Basin and continues to develop those resources in partnership with Marathon Oil Company and Unocal. In particular, in-holdings within the Kenai National Wildlife Refuge at the East Swanson Prospect will be a significant project in 2005.
- **Gas Pro/Northstar Energy/Alliance Energy** are three companies owned by the same general group of investors that have made several moves in 2004 on the lower Kenai Peninsula in preparation for 2005. All of this activity will be focused on the North Fork Unit, where an initial reserve of approximately 15 bcf was identified in the late 1960's. Northstar Energy successfully completed the approval process for a gas supply agreement with Enstar to deliver natural gas to the Homer and Anchor Point areas for utility uses. The next step that Northstar must now complete is the drilling of a second, and if needed third, development well at the North Fork Unit to prove up a 20 year uninterrupted supply of natural gas. To date, Northstar Energy has not announced firm plans for this next step. In the mean time, Alliance Energy has taken a stronger leaseholder position around the North Fork Unit. No firm plans for exploration have been announced for these new lease tracks.
- **Pelican Hill Oil & Gas** is another new independent explorer in the Cook Inlet Basin. Focused on the Westside of Cook Inlet, Pelican drilled an exploration well in 2004 which was not successful. Four more exploration wells are planned to be completed by spring 2005.
- **Other Companies** with lease positions but no active natural gas exploration efforts planned or announced for 2005 include:
 - **Escopeta Oil & Gas/BBI**, the largest offshore leaseholder in Cook Inlet, estimates its leases contain 6.3 trillion cubic feet of natural gas¹⁴ and is seeking investors.

¹³ Petroleum News Publication "The Explorers," Aurora Gas LLC profile, page 30

¹⁴ Petroleum News Publication "The Explorers," Escopeta Oil & Gas/BBI profile, page 81

- **Pioneer Natural Resources**, with significant leases in the Mat-Su region, has no plans announced.
- **Pioneer Oil Company**, with leases on the Westside and in Mat-Su region, has no plans announced.
- **Storm Cat Energy Corp.**, with leases in the Mat-Su region, has no plans announced.

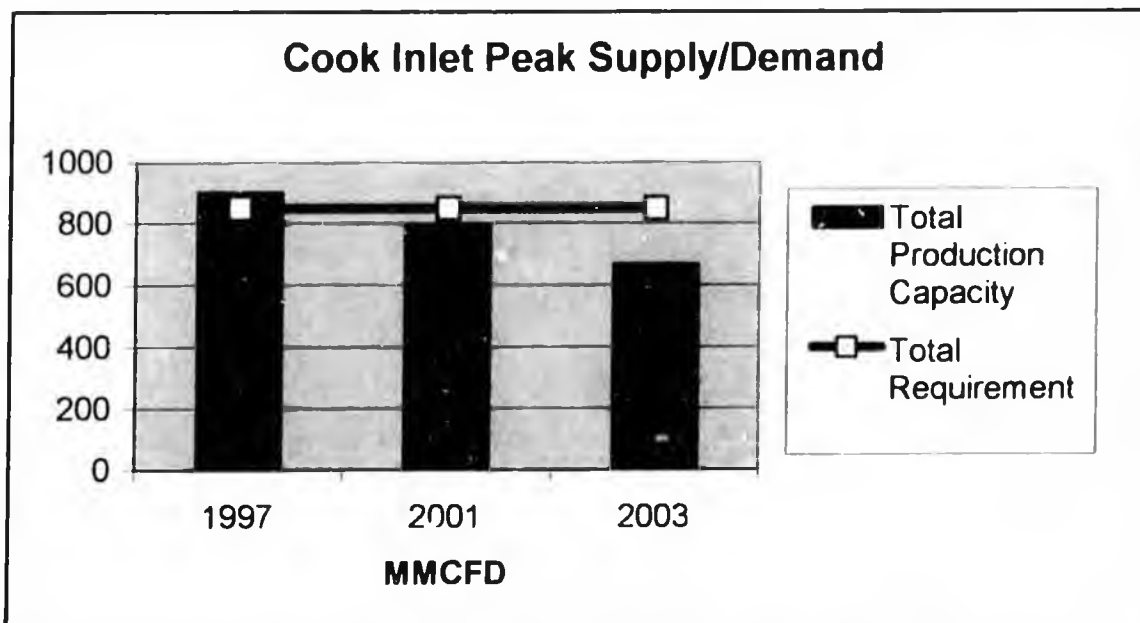
Natural Gas Deliverability

The ability to deliver sufficient quantities of natural gas to meet peak demand days has become a growing problem for several years and could become more pronounced in 2005 and 2006. Simply put, if deliverable volumes of natural gas are insufficient to meet peak demand, then usage by industry and utilities is curtailed on a prioritized basis. This problem becomes most pronounced on the coldest, darkest days of winter when utility demand for natural gas is at its highest, and is compounded by the normal demand patterns of industrial users of natural gas.

First to be curtailed are the industrial users such as Agrium and ConocoPhillips LNG plants, followed by the utilities if necessary. Industry estimates vary, but the current range for peak demand day requirements for all industrial and utility users in the Cook Inlet Basin is between 850 to 900 million cubic feet per day.

The problem of deliverability of natural gas has become more pronounced in recent years due to the aging nature and physical location of natural gas fields within the Cook Inlet natural gas system. It is not so much a lack of natural gas in the ground, but rather the growing lack of ability to flow sufficient amounts of natural gas to meet peak demand requirements. As natural gas wells and fields age, flow rates that previously might have been, as an example, 4 to 6 million cubic feet (mmcf) or more per day drop significantly. Additionally, as older fields are depleted, existing pipeline systems may not be able to transmit sufficient volumes of natural gas from new fields that are being brought on line to replace aging and depleted natural gas fields.

The following graph provided by Marathon Oil Company in early 2004, though somewhat dated, gives a clear example of the significance of this issue.



To put this into better perspective, Agrium uses 155 mmcf per day at maximum capacity and the ConocoPhillips LNG plant uses 207 mmcf per day at maximum capacity. Conversely, electric and heating utilities use nearly 500 mmcf per day on peak demand days. As the problem of deliverability has grown in recent years, Agrium has born the brunt of winter curtailment requirements to meet demands of the utilities to heat and light homes and businesses of the Cook Inlet homes and businesses.

There are varying opinions within industry circles, with the most pessimistic opinion being that the issue of deliverability could become so pronounced in the near future that there is an outside chance of curtailment of natural gas deliveries to utility consumers as early as the winter of 2005/2006 if solutions are not forthcoming. Solutions to this problem will likely be a combination of new exploration & discovery efforts, rework of aging natural gas wells and fields to improve flow rates.

Other options include improvements to the pipeline systems through increased compression, remediation of choke points in the pipeline system and addressing issues related to the common carrier status of key pipelines to provide improved access by both producers and consumers of natural gas.

A more immediate solution to the deliverability issue now under development is establishment of a natural gas storage facility in Unocal's Swanson River Field. By making use of a depleted underground reservoir structure within the Swanson River Field, Unocal proposes to inject several billion cubic feet of natural gas into the structure during low demand summer months where natural gas will be stored until needed.

During peak demand periods in the winter, this storage facility can take advantage of existing pipeline systems and be tapped to deliver the higher volumes of natural gas needed to meet utility requirements, with the added benefit of taking some pressure off of industrial users to curtail their use of natural gas for plant operations. This project does face potential permitting challenges that may delay or cancel the natural gas storage project, as it is sited within the Kenai National Wildlife Refuge (KNWR), even though the project will not expand the footprint of existing oil and gas facilities within the KNWR. Discussions are ongoing over these permit issues between the industry, State of Alaska and the Federal agencies involved to address these permitting issues.

North Slope Gas Line Proposals

While the Cook Inlet Basin continues to offer many potential opportunities for significant natural gas discoveries, prudence suggests that sources of natural gas from outside the Cook Inlet Basin should also be explored and developed to assure that long-term natural gas supplies are secured for economies of the Railbelt region. North Slope natural gas offers one such outside source that could supply part or all of the gas demands for the Cook Inlet Basin and Railbelt region for several decades.

At this time, there are six different North Slope gas pipeline related projects in varying stages of development. The following is a brief descriptive of the scope of each project proposed:

- **The 'Big 3' producers 4.5 bcf/day project to the lower 48: \$19 billion with projected completion by 2016.** Known as the 'Highway Route,' this project is

proposed by Exxon, BP Exploration and ConocoPhillips to build a line from the North Slope to Chicago along the TAPS corridor and the Alaska Highway through Canada. This project currently has an application under consideration by the State of Alaska for a fiscal contract under provisions of the Alaska Stranded Gas Act. This contract does not guarantee construction of a pipeline, but does set fiscal terms between the State of Alaska and the applicant if the pipeline is constructed. This application will be presented to the Legislature in the later part of the 2005 legislative session for an up or down vote following a minimum 30 day public comment period. While details of the terms of the fiscal contract proposal for this project are not yet available, the State of Alaska has commented that there are provisions to 'allow' for in-state access to North Slope natural gas transmitted through the pipeline. This would likely include access for a spur line to Cook Inlet, though no company or entity has been identified that will build this spur line as of yet. Financing of this project is likely to be a combination of equity investment and debt financing. The State Administration has also posed the idea of State investment in this project if it goes forward.

- **TransCanada and Enbridge 2.6 to 5.0 bcf/day project to Alberta proposals: Up to \$16 billion with projected completion by 2012.** Each of these Canadian pipeline companies has proposed to build pipeline projects from the North Slope to Alberta, stating that existing capacity is available from the Alberta Hub to transmit ANS natural gas to Chicago or other destination hubs in the lower-48 and eastern Canada. Neither of these projects has a defined component to build a spur line to Cook Inlet, though both have stated a willingness to consider allowances for this need in their respective projects. TransCanada has disputed the ability of any other company to obtain the necessary permits to build a lower-48 pipeline through Canada, claiming that those exclusive permits are already in TransCanada's possession under the terms of the 1978 Canadian Northern Pipeline Act.¹⁵ A resolution to this point of contention is under development within the Canadian Federal government. Financing of either project would likely consist of both equity investment and debt financing.
- **Alaska Natural Gas Development Authority (ANGDA) 2.0 Bcf/day LNG project: \$12 billion with projected completion by 2012.** ANGDA was established by ballot proposition in the 2002 Statewide election. ANGDA was tasked with developing an LNG pipeline project from the North Slope to Valdez, including a spur line to Cook Inlet from Glenallen. Successful State legislation sponsored by Senator Tom Wagoner and Representative Mike Chenault expanded the scope of ANGDA's mandate to include the ability to build a gas transmission line from the North Slope to Cook Inlet. Studies commissioned by ANGDA are in development which examine several aspects of an LNG project to either Valdez or Cook Inlet. Currently, ANGDA has shifted its main focus from the LNG projects to getting North Slope natural gas to Cook Inlet.¹⁶ This project will likely be 100% debt financed.
- **ANGDA 1.0 Bcf/day Bullet Line to Cook Inlet project: \$3.0 billion with projected completion by 2010.** This new project has recently risen to the forefront of projects ANGDA is examining in detail. The project would build a 24-inch line from the North Slope to Cook Inlet to serve local utilities, as well as existing and new industrial

¹⁵ Petroleum News, "Showdown looms," January 2, 2005

¹⁶ Alaska Journal of Commerce, "LNG Authority shifts focus to Southcentral," November 28, 2004

users. Currently commissioned studies will examine aspects of this project in conjunction with the larger LNG and smaller spur line project analysis.¹⁷

- **ANGDA 500 mmcf/day Spur Line to Cook Inlet project: \$300 million with projected completion by 2010.** This project, part of ANGDA's original voter mandate, is under active study. This project is envisioned to construct a 24-inch pipeline from Glenallen to Cook Inlet and would connect with a larger line either to the lower 48 or to Valdez and would serve existing utilities and existing industrial users. This project will likely be 100% debt financed.
- **The Municipal Port Authority Valdez LNG project: \$26 billion (last public cost estimate) with projected completion by 2011.** The Municipal Port Authority was originally established by the Fairbanks Northstar Borough, the City of Valdez and the North Slope Borough. The North Star Borough withdrew from the Port Authority in 2004. Earlier in 2004, the port authority promoted a plan to line up purchase deals with North Slope producers, negotiate contracts to sell the gas and obtain 100% debt financing to build a \$26 billion project that would take more than 6 billion cubic feet of gas a day from the slope. About half would go by pipeline through Canada on its way to Lower 48 markets. Almost 2.7 bcf per day would move to Valdez, where it would be liquefied for shipment to Far East and U.S. West Coast markets.¹⁸ In late 2004, this plan changed in scope so that the project is now planned to take 3 billion cubic feet a day off the North Slope in a 48-inch pipeline, but could easily ramp up to 4 bcf to 4.5 bcf a day. Of the initial volume, not less than 2.5 bcf a day would go to Sempra LNG in Baja, one of six proposed LNG receiving facilities for the California and Mexican market. The size of a spur line to Southcentral Alaska, part of the port authority's plan to provide gas for in-state use, has not been determined yet. A total project cost for the revised project has not been publicly defined to date.¹⁹ Again, this project would be 100% debt financed.

With this variety of projects in varying stages of development, it is difficult at this time to identify the project with highest likelihood of successful completion, especially in regards to successfully connecting Cook Inlet to North Slope natural gas reserves. In 2005, it is vital that the Kenai Peninsula Borough continues to be vigilant on two key issues.

The first is the terms of any fiscal contract negotiated between the State of Alaska and any applicant under the terms of the Stranded Gas Act (SGA). Even though the Kenai Peninsula Borough is likely not physically located within the route of any proposed North Slope natural gas pipeline, provisions of the SGA allow the State of Alaska to waive any or all municipal property or sales taxes that could be levied on facilities or companies involved in the construction of a North Slope natural gas pipeline. This could include companies and facilities located within the Kenai Peninsula Borough. The SGA does offer the option of a Payment In Lieu of Taxes (PILT) to municipalities which could offset part or all of any municipal taxes waived by the State of Alaska as part of a SGA fiscal contract. But the devil is in the details of any such agreement and the Kenai Peninsula Borough must closely analyze any proposals in this vein to protect the interests of the Borough.

¹⁷ Petroleum News, "ANGDA talks contracts with prospective bidders," October 17, 2004

¹⁸ Petroleum News, "Muni gas line trio settle dispute," June 13, 2004

¹⁹ Petroleum News, "Gas pipeline authority teams with Sempra Energy," December 26, 2004; Alaska Gasline Port Authority website, www.alaskagaslineportauthority.com

The second key issue is access to North Slope natural gas through either a spur line connected to a larger project, or a direct pipeline from the North Slope to Cook Inlet. While Cook Inlet still has a high potential for significant new natural gas reserves yet to be discovered, recent events have underlined the need to diversify the sources of natural gas delivered to the communities of the Cook Inlet Basin. In a diversified Cook Inlet supply model, North Slope natural gas should be viewed as a long-term component to the region's economic planning, both as a general energy source for community growth and a feedstock source for industrial growth. In 2004, the U.S. Geophysical Survey raised its speculative estimate of potential conventional natural gas reserves on the North Slope to 211 trillion cubic feet.²⁰ This potential reserves estimate does not include the 33+ trillion cubic feet of proven reserves already identified on the North Slope. The Kenai Peninsula Borough must advocate throughout the SGA contract negotiation process for provisions that allow access to North Slope natural gas, as well as providing support for any economically viable pipeline project that would connect the Cook Inlet Basin to North Slope natural gas reserves in a timely manner.

Lower Cook Inlet Federal OCS Lease Sale 199

In 2004, the Minerals Management Service (MMS) offered 2.3 million acres in the Outer Continental Shelf (OCS) area of lower Cook Inlet for lease through Lease Sale 191. Three days before the sale was to take place, Lease Sale 191 was cancelled due to a lack of bidders. In follow up conversations with potential bidders, MMS identified several factors that made the sale unattractive to industry. One of the key issues was the lack of risk reduction for the early phases of any exploration effort.

In particular was the lack of incentives to offset the high risk nature of exploration efforts. The terms and incentives of Lease Sale 191 were weighted towards the production side. This meant that, from the prospective bidders perspective, cost mitigation only kicked in after oil or natural gas were discovered. This was a real disincentive to industry as these terms did very little to reduce the financial risks associated with the highest risk phases of any effort to develop a lease in the OCS. An example of the high cost aspects of exploration is the cost of mobilizing a jack-up drill rig discussed earlier in this report.

The MMS is moving forward with Lease Sale 199, scheduled for May of 2006, and is attempting to address the concerns of industry by revising the proposed lease terms within its statutory scope of authority to do so. The MMS has issued a Request for Information and Notice of Intent to Prepare an Environmental Assessment for Cook Inlet Sale 199²¹ and will take public comment through February 10th, 2005. A Final Notice of Sale will be issued in early 2006.

Additional Federal legislation will need to be pursued with the Congressional delegation to address coastal community revenue sharing, in particular if the Federal Energy Bill is revived in some form. It may also be necessary to pursue additional authority for MMS to offer additional lease incentives such as 'dry hole' credits and similar incentives available in the Gulf of Mexico.

²⁰ Petroleum News, "North Slope likely has 211 tcf undiscovered gas," August 1, 2004

²¹ Federal Register, Vol. 69, No. 247 / Monday, December 27, 2004 / Notices, page 77265

Bristol Bay Oil & Gas Area-wide Lease Sale

Another potential source of natural gas from outside the Cook Inlet Basin is the Bristol Bay region. Geographically much closer to Cook Inlet than the North Slope, this region offers significant potential for economically accessible natural gas and oil reserves. Of most significance to the purpose of this report are the potential natural gas reserves.

The Bristol Bay region has seen limited oil & gas exploration efforts since 1906. Twenty-six onshore wells and one offshore well have been drilled to date. The most recent exploration well was drilled in 1985. No commercial discoveries have been made to date, though oil and gas shows were evident in many wells. The last lease sale to take place in the region was a Federal offshore sale that drew \$96 million in bids. Nine years ago, those leases were bought back by the Federal government at the urging of local communities concerned with possible impacts to regional commercial fisheries.

In recent years, economic pressures have generated new calls from local community leaders for a renewal of oil & gas exploration in the Bristol Bay region, with a focus of support going towards onshore exploration only.²² The severely depressed economies of the region, driven largely by poor salmon prices, have created much of the support for new oil & gas exploration.

The proposed State of Alaska Bristol Bay area-wide lease sale (Appendix A: Map #1) encompasses 3.2 million acres, nearly 3 times the size of the proposed ANWR acreage. While no specific estimates of reserves are available from the State of Alaska, the Division of Oil and Gas has commented publicly that "...the oil potential is in the hundreds of millions of barrels and the gas is in the multiple trillions of cubic feet range."²³

Upon successful completion of the ACMP consistency determination and the Best Interest Finding processes, a lease sale is tentatively scheduled for October of 2005. Successful lease bids would be finalized by April, 2006. Efforts to begin exploration would likely begin in late 2006 or early 2007, pending necessary permits.

Proposed terms for the Area-wide lease sale include restrictions to onshore drilling only. Exploration of offshore acreage is allowed, but only by using directional drilling technology from onshore drill sites. The State offshore acreage extends to three miles offshore. No offshore facilities will be allowed.

In addition to the proposed Area-wide lease sale in 2005, an exploration license for approximately 329,000 acres surrounding the Dillingham area (Appendix A: Map #2), north of the proposed area-wide lease sale area was recently awarded. Specifically targeted for natural gas, this exploration license was awarded to Bristol Shores LLC, which is owned by four Native elders. Bristol Shores has committed to a \$3.2 million work commitment if the company accepts the seven-year license as proposed by the State of Alaska. This exploration

²² State of AK, Department of Natural Resources, Division of Oil & Gas, "Bristol Bay Basin Exploration License No. 1, Appendix A, "Summary of Public Comments and Responses."; Christian Science Monitor, "As fishing falls off, rural Alaska wants oil," November 12, 2003.

²³ Petroleum News, "Bristol Bay road considered," July 20, 2003

license did draw opposition from environmental groups concerned with possible impacts from natural gas exploration and production efforts, including an appeal and request for reconsideration of the State's Best Interest Finding supporting the exploration license award. The State denied the appeal and the environmental group that filed the appeal has stated it will not pursue its appeal in Superior Court.

The Kenai Peninsula Borough has several likely interests in the successful exploration and development of Bristol Bay oil and gas reserves. First is the potential of Bristol Bay natural gas reserves being delivered totally or in part to the Cook Inlet Basin as part of a diversified supply model.

Second is the likelihood that Cook Inlet based support companies will successfully bid on a number of contracts related to exploration & development efforts in the Bristol Bay Region. Given the similar environmental and working conditions in both regions, Cook Inlet support companies will have a strong edge on outside competitors for these contracts.

Third, the Cook Inlet, and in particular the Kenai Peninsula Borough, will be likely staging and logistics centers to support exploration and development in the Bristol Bay region. In particular, dock, port and airport facilities in Nikiski, Kenai and Homer are all strategically located to act as staging points for equipment and materials to be delivered directly by air or via ship and barge to proposed dock and road facilities in the Williamsport area of lower Cook Inlet. There are strong opportunities for the Bristol Bay oil & gas exploration infrastructure needs to complement the proposed Pebble Mine project road and port facilities and power grid needs.

And finally, this type of exploration effort will generate stronger economic ties between the communities of the Bristol Bay region and the Kenai Peninsula Borough. As improved road, port and air access is developed, it will become more economical for general commerce to increase between the two regions.

To better facilitate these points, stronger relationships and shared goals need to be developed between the Kenai Peninsula Borough and its communities and the three Boroughs and the many communities of the Bristol Bay region. The Kenai Peninsula Borough has excellent resources and expertise to offer, both within and outside Borough government, that could be of great use to Boroughs and communities of the Bristol Bay region.

Crude Oil

This section will examine recent trends in oil production and proven oil reserves within the Cook Inlet Basin. An outlook for future production and possible solutions to declining oil reserves will also be examined.

Cook Inlet Crude Oil Production and Reserves

The following chart describes Cook Inlet proven crude oil reserves and total annual production since 1997.

Estimated Cook Inlet Basin Proven Oil Reserves & Total Annual Production 1997 to 2004		
Year	Proven Reserves ²⁴ (Million Barrels)	Total Annual Production ²⁵ (Million Barrels)
1997	120	12.167
1998	76	11.810
1999	76	10.905
2000	72	10.720
2001	186	11.497
2002	186	11.284
2003	166.7	10.059
2004	80	9.092 ²⁶

The significant upward changes in proven reserves between the years 2000 and 2002 were based on initial estimates for the Redoubt Shoals Field under development by Forest Oil Company through the Osprey platform. The 86.7 million barrel reduction in proven reserves from the year 2003 to 2004 was mostly based on the recent re-evaluation of the Redoubt Shoals Field by Forest Oil Company that significantly down-graded the reserves of this field by 49 million barrels.²⁷ Redoubt Shoals Field is now forecasted by the State of Alaska to cease production after 2010.²⁸ In addition to reductions at Redoubt Shoals, significant reductions in proven reserves totaling 34.2 million barrels from 2003 to 2004 at the Granite Point, McArthur River and Middle Ground Shoals units were due to both ongoing production and re-evaluation of the proven reserves data by the State of Alaska.

The following graph²⁹ describes historic and forecasted crude oil production in Cook Inlet through 2022.

²⁴ State of Alaska, Department of Natural Resources, Division of Oil and Gas, 1997-2004 Annual Reports

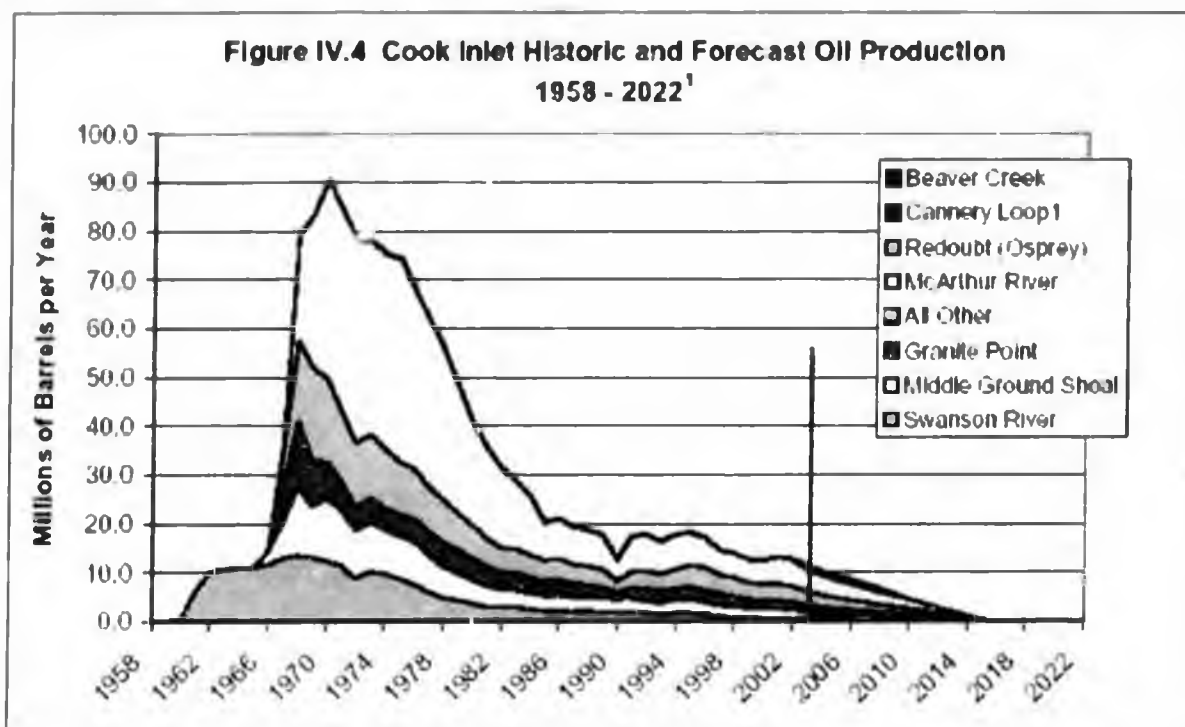
²⁵ State of Alaska, Department of Natural Resources, Division of Oil and Gas, 1997-2004 Annual Reports

²⁶ State of Alaska, Department of Natural Resources, Division of Oil and Gas, 2004 Annual Report, Page 4-22
Forecast for 2004 Cook Inlet Oil Production

²⁷ Petroleum News, "Redoubt Flame Dwindles," February 1st, 2004

²⁸ State of AK, Department of Natural Resources, Division of Oil & Gas, 2004 Alaska Oil & Gas Report, page 4-22

²⁹ State of AK, Department of Natural Resources, Division of Oil & Gas, 2004 Alaska Oil & Gas Report, Page 4-23



All proven reserves of Cook Inlet oil are now forecasted by the State of Alaska to be depleted by the end of 2016³⁰ unless new reserves are found and developed. This is significant in that the Tesoro refinery is the sole consumer of all Cook Inlet oil production, which accounts for approximately one third of Tesoro's requirements for feedstock. If this production decline curve continues unchecked, Tesoro will ultimately meet all its feedstock requirements using a combination of North Slope crude oil and shipments of opportunity from other sources such as the Russian Far East. This will result in a significant increase in oil tanker traffic in the Cook Inlet to deliver this feedstock to the Tesoro refinery unless new reserves are developed within the Cook Inlet Basin.

Based on government and industry speculative projections,³¹ there are potential oil reserves yet to be discovered within the Cook Inlet Basin that could be in excess of 1.0 billion barrels of recoverable oil. However, several obstacles must be overcome before active oil exploration could be expected to commence in the Basin to explore these estimates. Those obstacles include the likelihood that reserves will lie within technically difficult geological structures, making both discovery and development very expensive propositions for industry.

Substantial investments will need to be made in new and upgraded facilities and equipment to adequately explore for these new oil reserves. Possible solutions include the State of Alaska adopting new capital reinvestment credits for onshore and offshore facilities improvements needed to explore more technically challenging structures and traps. In addition, new exploration incentives could be implemented for both seismic and exploration drilling work that mitigate risks associated with discovery of these technically more demanding geological structures and traps.

³⁰ State of AK, Department of Natural Resources, Division of Oil & Gas, 2004 Alaska Oil & Gas Report, page 4-22

³¹ U.S. Minerals Management Service, OCS EIS/EA MMS 2003-055, Oil & Gas Lease Sales 191 & 199, page B-4 & Table V-10; Petroleum News, "Escopeta Oil's search for Cook Inlet's 'missing giants,'" August 29th, 2004

There is also a likely need to provide additional Federal incentives to reduce risks during the exploration phase of oil & gas development within the Federal waters of the lower Cook Inlet. The Outer Continental Shelf (OCS) represents a significant portion of the potential undiscovered oil reserves of the Cook Inlet Basin. However, OCS Lease Sale 191 that was scheduled in May, 2004 was cancelled due to lack of industry interest. This lack of interest was due in part to the nature of the lease sale incentives offered. These incentives were weighted towards royalty reductions once a discovery was made and production had begun. There were no provisions for financial risk reduction during the exploration phase of lease development. Current Federal law does not allow for this kind of risk reduction incentive during exploration and may need to be addressed through new Federal legislation.

Of most significance is the need to mobilize a jack-up drill rig to Cook Inlet to allow for offshore exploration of new offshore oil reserves. Industry estimates vary, but the likely cost to mobilize a jack-up drill rig to Cook Inlet could exceed \$20 million. This cost estimate only covers the cost to deliver the jack-up drill rig to Cook Inlet and then remove it once exploration drilling is completed. Actual drilling will require additional funds to be invested by the company or companies interested in exploring their prospective offshore leases. This mobilization cost has to date been an insurmountable risk factor that industry has been unable to overcome. It is likely the State of Alaska will need to identify an appropriate form of incentive to reduce this risk to a manageable level that facilitates the contracting of a jack-up drill rig to Cook Inlet. Ultimately, with 90% of potential new oil reserves likely to be discovered in offshore areas of the Cook Inlet Basin,³² mobilization of a jack-up drill rig to Cook Inlet is a vital piece to development of new oil reserves within the Cook Inlet Basin.

Cook Inlet Crude Oil Exploration Outlook for 2005

The outlook for crude oil focused exploration in 2005 is minimal at best, though there is new activity. A few new exploration drilling efforts are planned and there is some exploration related activity planned. Several companies are active in crude oil production in Cook Inlet. Here is a recap of those companies:

- **Unocal** will continue with a status quo work plan for 2005. Most of Unocal's oil reserves are offshore in the Granite Point and McArthur River Units. The Swanson River Unit, Trading Bay Unit and other smaller fields make up the remainder. The Baker and Dillon platforms will likely remain shut in. Unocal continues to be the largest producer of crude oil in Cook Inlet and will account for over 80% of Cook Inlet crude oil production in 2005.
- **XTO Energy** is the only active driller in the offshore areas in 2005. XTO will complete a schedule of rework and development wells later this spring. XTO's two offshore facilities, the "A" and "C" platforms, will account for over 10% of Cook Inlet crude oil production in 2005.
- **ConocoPhillips** has one active exploration effort in Cook Inlet at the Cosmopolitan Unit just north and offshore of Anchor Point. Known as the "Cosmo," this unit has seen significant exploration in recent years with two world class direction drilled exploration wells drilled to targets three miles offshore. While no definitive results have been announced, ConocoPhillips has just committed to the State of Alaska to

³² U.S. Geological Survey National Assessment, 1995 Circular 1118

perform an extensive 3-D seismic survey of the Cosmo by November of 2005, and may choose to commit to a third exploration well in 2006. Ultimately, it is likely that if this prospect is deemed commercially viable, it will need to be developed using an offshore platform.

- **Forest Oil Company** has no plans for new crude oil exploration in 2005. Enhanced Oil Recovery (EOR) has been approved by the State of Alaska for Forest Oil's only offshore facility, the Osprey Platform. However, crude oil production is forecasted to end at the Redoubt Shoals Unit in 2010.
- **Aurora Gas LLC** has announced plans to drill four exploration wells focused on crude oil in 2005. Two of these wells will be on the Westside of Cook Inlet, while the other two wells will be drilled on the Kenai Peninsula. One will be drilled just south of Anchor Point and the second well will be drilled north of Kasilof. Aurora estimates there could be 400 million barrels of unrisks expected recoverable reserves and 140 million barrels of risks reserves.³³
- **Other Companies** with lease positions or small operations in Cook Inlet, but with no plans for new exploration efforts in 2005 include:
 - **Prodigy Alaska LLC**, with significant offshore leases, is seeking investor to develop its estimated crude oil reserves potential of 111-358 million barrels of oil equivalent.³⁴
 - **Escopeta Oil & Gas/BBI**, the largest offshore leaseholder in Cook Inlet, is seeking investors to develop its estimated crude oil reserves potential of 1.3 billion barrels.³⁵
 - **Devon Energy** is a new company to Cook Inlet and does not own any leases outright. However, Devon has recently increased its ownership position in the Cosmopolitan Prospect. While still a minority owner, this new investment could be significant.³⁶

Other Projects and Issues

DR&R Standards for Cook Inlet Offshore Platforms

After 40 years of offshore exploration and development within the Cook Inlet Basin, the issue of Dismantling, Removal and Restoration (DR&R) is coming to forefront with other policy issues important to the oil & gas industry. Currently, while the operators of the 16 existing offshore platforms are required to dismantle and remove the platforms once they are "abandoned," there are no specific DR&R standards for Cook Inlet offshore platforms. Since all existing platforms are located within State waters, Federal authority is restricted to the general terms of the permits issued by the U.S. Army Corps of Engineers. The State statute governing DR&R is very general, leaving Alaska Department of Natural Resources with great latitude regarding platform DR&R.

Industry is beginning to actively seek more clarity on this issue, with several public comments in recent public forums by Unocal about the need to adopt more defined standards for DR&R. This has ramifications on several fronts, including on the sale of existing platforms that still

³³ Petroleum News Publication "The Explorers." Aurora Gas LLC profile, page 30

³⁴ Petroleum News Publication "The Explorers." Prodigy Alaska LLC profile, page 79

³⁵ Petroleum News Publication "The Explorers." Escopeta Oil & Gas/BBI profile, page 81

³⁶ Petroleum News Publication "The Explorers." Devon Canada Corporation profile, page 80

have economic life and on the removal of platforms that have reached the end of their economic life. There is also a preliminary study on the DR&R issue commissioned by Cook Inlet Regional Citizens Advisory Council that is in the final stages of internal review before being released to the public.

The Kenai Peninsula Borough should continue to monitor this issue and be prepared to comment on any standards proposals that may come forward in 2005 and beyond. Tens of millions of dollars worth of AS 42.56 taxable infrastructure, as well as several hundred existing and future jobs could be affected by any new standards proposed.

Cook Inlet National Pollutant Discharge Elimination System (NPDES) Oil and Gas General Permit

Cook Inlet offshore oil and gas platforms are currently allowed under the terms of the current NPDES general permit, issued by the U.S. Environmental Protection Agency (EPA), to discharge treated produced water into Cook Inlet. These authorized treated discharges include drilling fluids & cuttings, deck drainage, sanitary wastes, domestic wastes, desalination unit wastes, non-contact cooling water, uncontaminated ballast water, bilge water and other fluids generated by operations & maintenance. It should be noted that while the permit covers these discharges, not every facility discharges all these fluids.³⁷ These waste streams are controlled in a similar, if not more restrictive manner, as the sewage outfall of waste treatment plants in several Cook Inlet cities such as Anchorage, Kenai and Homer.

The implication of this permit to the oil & gas industry is that if permit standards for allowable levels of discharge is restricted to significantly lower levels, the cost of retrofitting or upgrading platforms may be non-economic and could result in the closure of one or more of the offshore platforms currently operating in Cook Inlet.

The existing permit expired April 1st, 2004 and was administratively renewed on a temporary basis until the permit renewal process is completed. Previous EPA estimates for a completion date for this permit renewal process was projected for September, 2005. However, EPA issued a notice on January 13th that the schedule was about to be revised, so this completion date may be in doubt.

When it is finally issued, the renewed NPDES general permit could negatively impact a significant portion of the Kenai Peninsula Borough workforce and AS 43.56 taxable properties within the Kenai Peninsula Borough. The Kenai Peninsula Borough should continue to monitor this issue closely as it develops and be prepared to offer comment where appropriate.

Pebble Gold-Copper Project

The Pebble Gold-Copper Project, located within the Lake & Peninsula Borough (Appendix A: Figure 1-1) near the community of Iliamna, will have ripple effects within the economy of the Kenai Peninsula Borough. In the context of this report, if this project goes forward it will likely create new economic dynamics within the Cook Inlet oil & gas industry and support industry.

³⁷ U.S. Environmental Protection Agency, "Cook Inlet General Permit Information Sheet, February 13, 2004

The Kenai Peninsula Borough Administration has coordinated several opportunities in 2004 for officials to meet with representatives of the City of Homer, Homer Chamber of Commerce, City of Kenai and Kenai Chamber of Commerce and numerous companies through out the Homer, Kenai, Seward and Nikiski areas. These meetings have been very productive in gaining the attention of Northern Dynasty and bring their focus on to the many services and facilities the Kenai Peninsula Borough has to offer in support of the Pebble project. It has also helped these numerous Peninsula entities to gain a better understanding of the needs of the Pebble project and Northern Dynasty Minerals.

The Pebble project will develop what appears to be a world class gold, copper, silver and molybdenum deposit through an open pit mine and mill that will process between 100,000 and 200,000 tons per day of raw ore.³⁸ Construction will, by conservative estimates begin in 2008, with operations beginning in 2010.

In support of the project, several infrastructure components must be developed including an 85+ mile road connecting the mine to Cook Inlet, an improved port at the Cook Inlet terminus of the road, a support industry base able to offer skills and services specific to the mine operations and a power generation and delivery system capable of delivering 200+ megawatts of electricity to operate the mine. These infrastructure and workforce components will interact with Cook Inlet oil and gas industry on several levels.

First, the new road and port connection to Bristol Bay will facilitate the ability of Cook Inlet based exploration and support companies to better meet mobilization and services needs for any exploration efforts in that region. This road will offer 365 day a year access to the region. If the road and port are not available, this severely restricts the ability to mobilize equipment to the region. This restricted seasonal access in the summer would be by barge and ship, and by aircraft only in the winter.

Second, the Pebble project offers an excellent opportunity for many Cook Inlet oil & gas support companies to expand their scope of services to include mining. Many of the disciplines and skills needed for support of mining operations are very similar to those needed to support oil & gas exploration. Several support companies with operations based on the Kenai Peninsula are in varying levels of dialog with Northern Dynasty to better understand the needs of the project and how their companies can better compete for project contracts.

Finally, there will be hundreds of jobs that will likely be filled by Kenai Peninsula workers if the project begins construction and moves into active operations. The Lake and Peninsula Borough and other boroughs and communities of the Bristol Bay region should and will have first chance at filling the 2,000 construction and 1,000 operations jobs that this project will offer. But with a general population of just over 8,000 in the area from Egegik to Dillingham to Iliamna, it is highly unlikely that the local population of the region could provide the entire workforce needs of this project. The Kenai Peninsula Borough, with its substantially larger population, existing trained workforce and significant training facilities already in place in Kenai, Seward, Soldotna and Homer, is in an excellent position to fill a significant portion of the workforce needs of the Pebble project.

³⁸ Northern Dynasty Minerals, Ltd., Project description, www.northerndynastyminerals.com.

As the Pebble project continues to be developed (Appendix A: Figure 1-2 & 1-3), the Kenai Peninsula Borough should be very active in helping to coordinate the efforts of the communities and industries within the Borough to identify and make the most of opportunities the Pebble project will offer. The Kenai Peninsula Borough should also be actively coordinating its efforts with the Lake and Peninsula Borough and other appropriate entities in the Bristol Bay region to provide for complimentary efforts between the two regions that maximize opportunities for both.

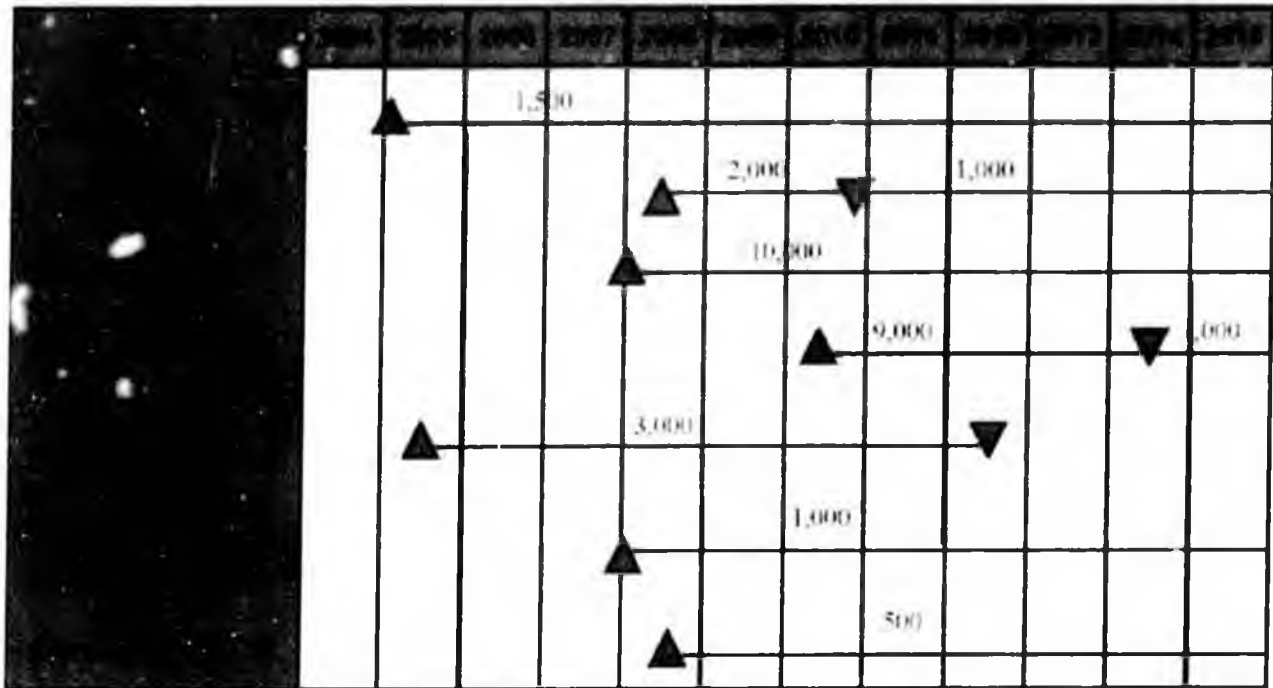
Workforce Development

It has become increasingly apparent in the last year that there are several major projects on the horizon that have reached varying degrees of likely success. Any combination of these projects could create significant demands on the workforce training facilities of the Kenai Peninsula Borough. In point of fact, a number of those projects by themselves would require a tremendous number of workers on their own. Several of those projects include:

- **NPRA-** Initial efforts have already begun to develop oil & gas reserves in this region west of the existing Prudhoe Bay fields. As exploration ramps up, and successful oil & gas discoveries are made, infrastructure will begin to extend out into NPRA. Conservatively, assuming modest success, this development would require at least 1,500 positions to fully develop the resources and infrastructure.
- **Pebble Project-** Slated to employ 2,000 construction and 1,000 operations workers, this project will likely begin construction in 2008 and operations in 2010. This time line assumes a three-year period for permitting and final design work.
- **ANWR-** Several assumptions must be made regarding this project using public information to date. First is that the Federal authorization will pass in 2005. The second assumption would be that a lease sale could be scheduled in time for initial seismic exploration to begin in the winter of 2008. The final assumption would be the size of the resource and the workforce that would be needed to develop it, including the induced jobs. With these assumptions in mind, approximately 10,000 jobs would be created in Alaska by this project.
- **Alaska North Slope Gas Line project-** Assuming that the "Big 3" producers project were to go forward, it would employ 9,000 construction and 1,000 operations workers. Based on published project information, earliest construction would begin in 2010, with earliest operations beginning in 2014.
- **Aging Oil & Gas Workforce-** Not a specific project, but a factor just the same, is the issue of the aging oil & gas workforce in Alaska. Approximately one-third of Alaska's oil & gas workforce is over age 50. This is significant in that most long-term oil & gas workers tend to retire at or near age 55. This represents in excess of 3,000 workers across Alaska that will need to be replaced just to maintain the status quo. Assuming most will retire by the time they are 58, this issue will be ongoing through 2012.
- **Bristol Bay Oil & Gas-** Assuming modest exploration efforts resulting in modest discoveries of new oil and gas reserves, approximately 500 workers will be needed to explore and develop these reserves. This is a very conservative estimate in light of the still speculative nature of the resources of this region .
- **Lower Cook Inlet OCS Leases-** Assuming two significant and distinct discoveries in this region, and using MMS estimates for workforce requirements per platform, exploration and development of this region will require approximately 500 workers.

Using the timelines identified by the MMS, this effort would begin in earnest during 2008 and continue into the future.

The really interesting part of this look at projects is when you line them all up and examine how they overlap. The following chart represents that examination:



If all projects were to go forward as described, there would be a need for 29,000 workers to facilitate the success of these projects. In particular, the period of 2008 to 2012 is a peak period for workforce requirements.

Obviously, the likelihood of every one of these projects going forward as described is questionable. But if even half of these projects, or in some cases even one project goes forward as planned, there will be a serious scramble to train Alaskans to fill those jobs unless preparations begin now to meet these needs in an organized and intelligent manner.

The training facilities located within the Kenai Peninsula Borough are in an excellent position to play a significant role in this effort. Those facilities include the Alaska Vocational Technical Center (AVTEC) in Seward, the Kenai Peninsula College (KPC) campuses in Soldotna and Homer, the Mining and Petroleum Training Service (MAPTS) headquartered in Soldotna, and the Alaska Regional Fire Training Center in Kenai.

All of these training facilities have specific strengths in facilities and programs that, when taken as a whole, offer an outstanding training infrastructure in place. However, given the workforce numbers, types of projects and skill sets that will be required, it is likely that these programs and facilities will need to be expanded to meet even a portion of the training demands that are looming on the horizon.

Preliminary efforts are already underway to coordinate planning between these facilities. An ad hoc group was formed earlier in 2004 that has been working to develop an organization to perform that coordination of planning, as well as to represent the Kenai Peninsula Borough

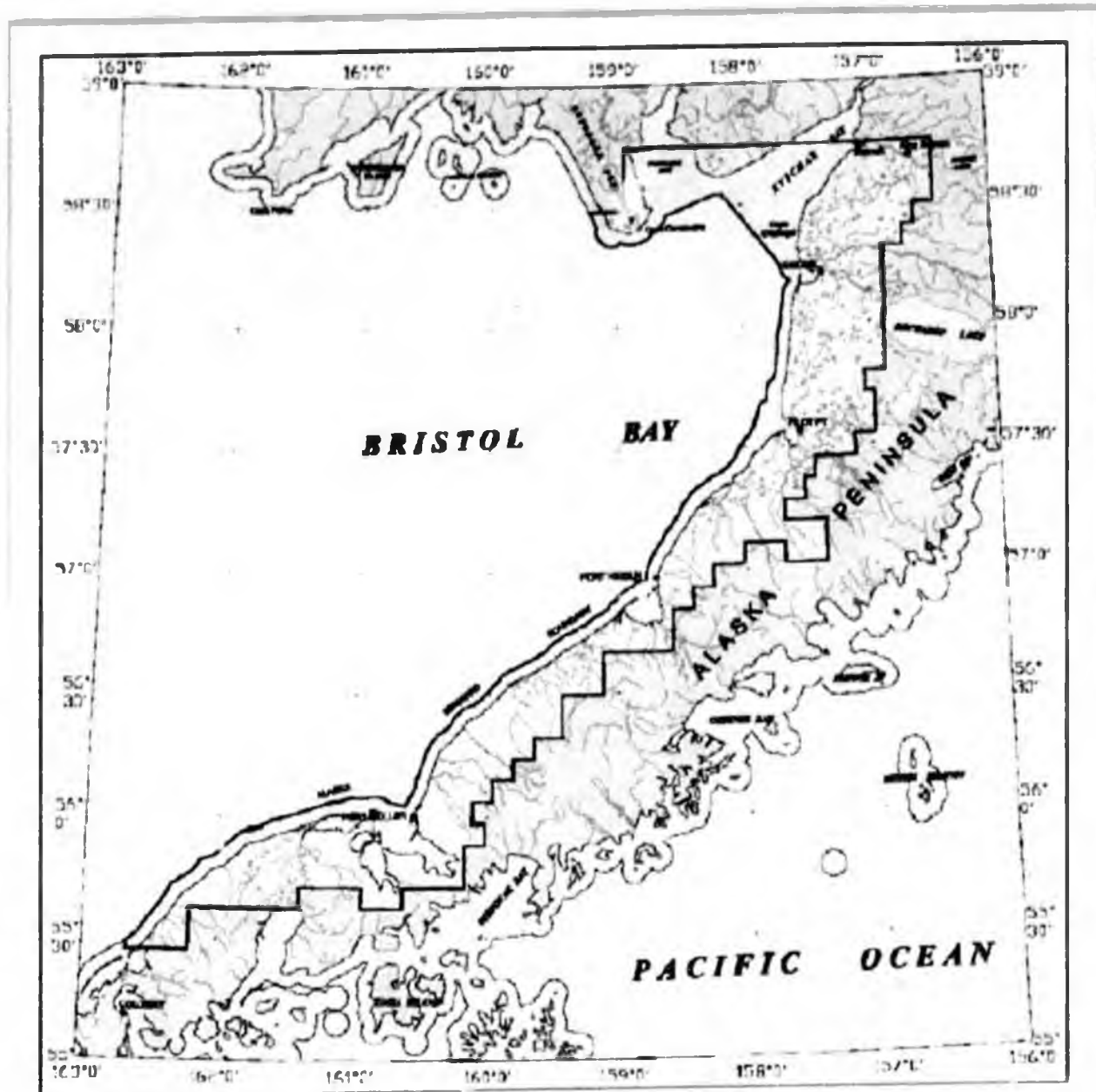
region to the Alaska Workforce Investment Board (AWIB) on an advisory basis. This ad hoc group, currently named the Kenai Peninsula Development Coalition (KPDC) is now working towards forming a more formal organization. Participants in this group include the training providers and the school district, chambers of commerce, trade unions, state and local agencies, and representatives of local business and industry. Additional participation is actively being sought from representatives active in industries not currently represented.

Ultimately, KPDC hopes to be active in identifying and obtaining training related funds from non-traditional grant sources such as industry and foundations, in addition to traditional grants from Federal and State agencies. These funds would then pass on to the existing training providers, the school district and other programs where appropriate to help promote a comprehensive training system based on the Kenai Peninsula Borough that addresses key training needs for new industry projects across Alaska, as well as the ongoing workforce needs of the existing industries and businesses of the Kenai Peninsula Borough.

The Kenai Peninsula Borough should continue to monitor and participate in the development of KPDC, and work to help strengthen and prepare the Peninsula based training facilities and programs, as well as the K-12 programs at the school district. Additionally, the Kenai Peninsula Borough should facilitate discussions between the Peninsula based training providers and the Lake & Peninsula Borough, Bristol Bay Borough and the North Slope Borough. The purpose of those discussion would be to identify and promote culturally sensitive programs that would bring students and trainees from these Boroughs to the Kenai Peninsula Borough for advanced training programs that would complement training programs already in place in those Boroughs.

Appendix A: Maps & Flow Charts

Map #1, Proposed Bristol Bay Area-wide Oil & Gas Lease Sale



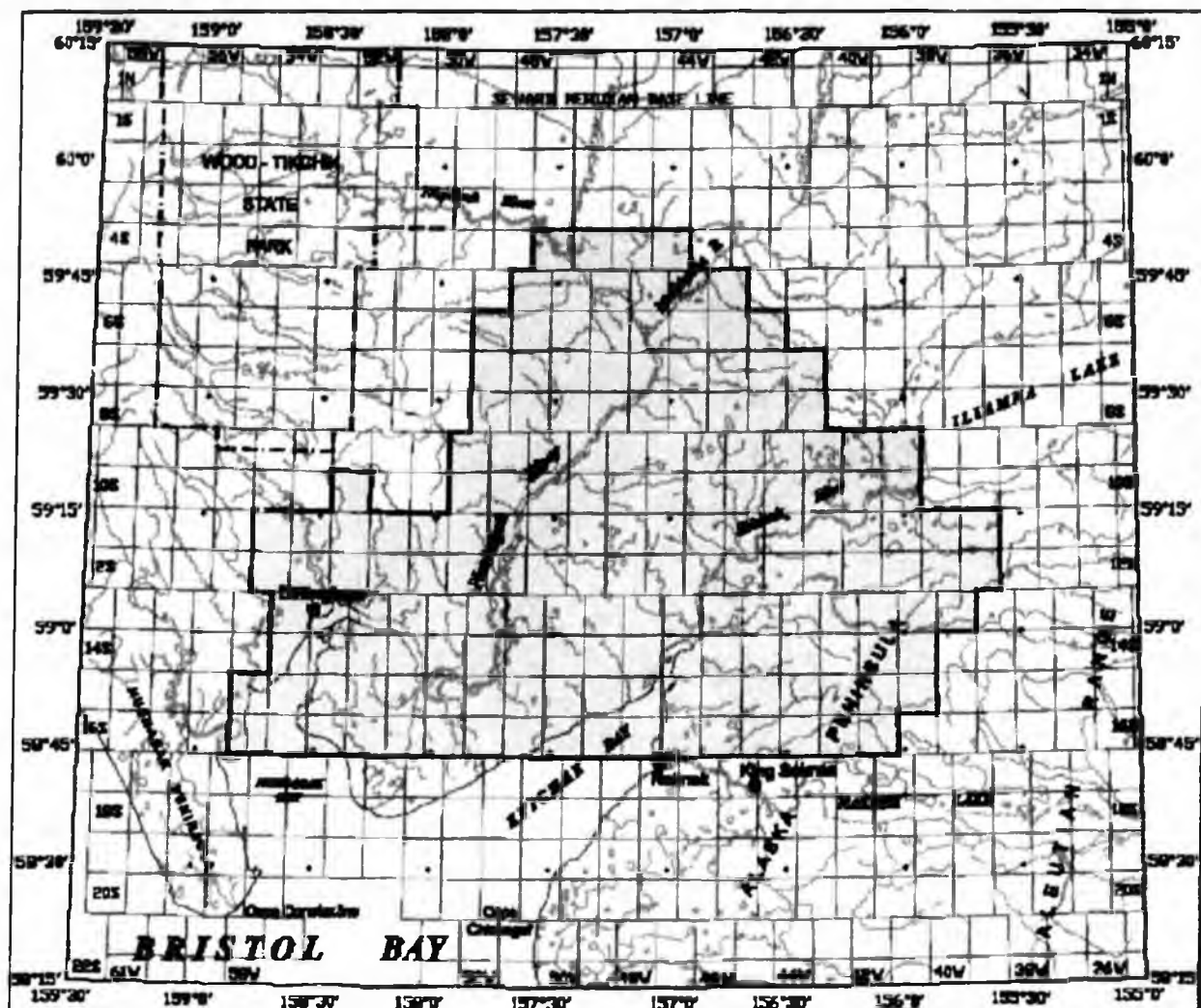
Proposed AK Peninsula Areawide Oil and Gas Lease Sale

Proposed Sale Area = 



Map prepared, edited, and published by the State of Alaska, Department of Natural Resources, Division of Oil and Gas.
 Alaska Data-Area Cartographic Project, 1977 North American Datum. Clarke 1866 spheroid with a central meridian of 150°20', edge latitude of 90°, northern parallel of 60°, and southern parallel of 30°. ADMR 1/83

Map #2, Bristol Bay Approved Exploration License Area

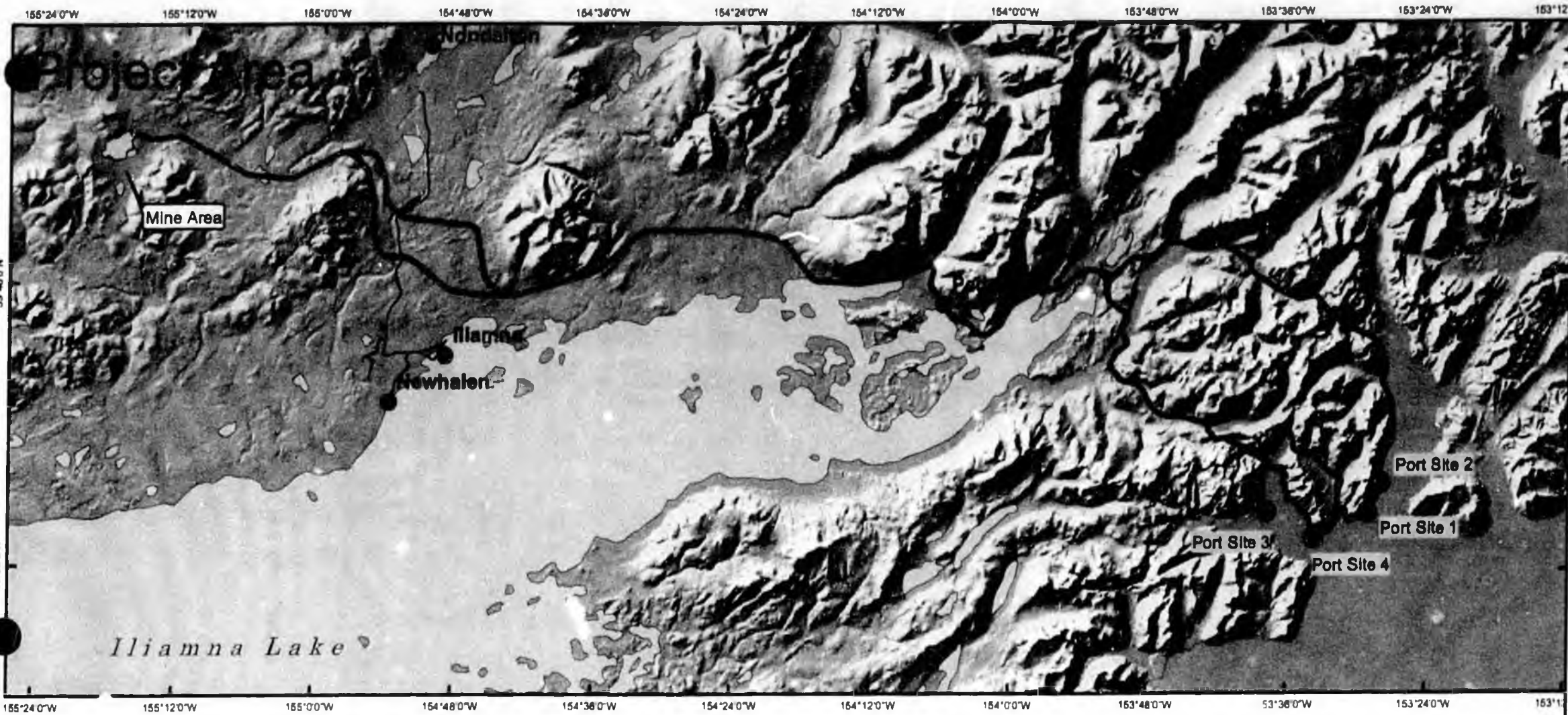


Bristol Bay Basin Exploration License Proposal

Area of Proposal =



Map compiled, edited, and published by the State of Alaska, Department of Natural Resources, Division of Oil and Gas.
 Alaska Equal-Area Conic Projection, 102° North American Datum, Clarke 1866 spheroid with a central meridian of 157°W, origin latitude of 60°N, northern parallel of 60°N, and southern parallel of 56°N. 7500



Northern Dynasty Mines inc.



DRAFT

Pebble Project

Pebble Project Area and Local Vicinity
Figure 1-1

Legend

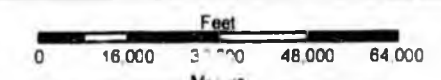
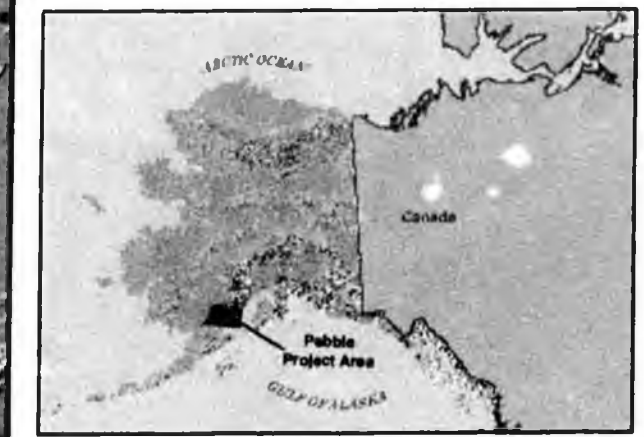
Routes of Interest

- Routes of Interest
- Orebody
- Existing Roads
- Port Sites

Pebble Project

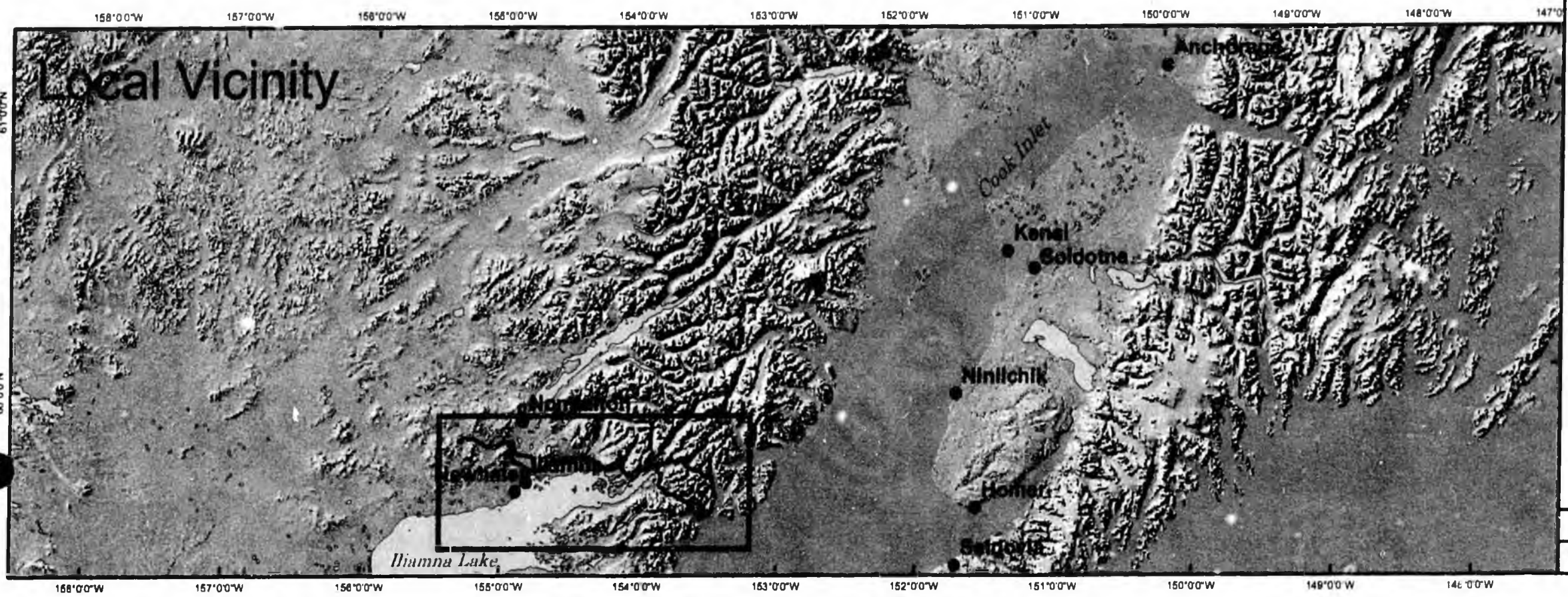
Received Access Routes AutoCAD file from PN&D. 6/7/2004

Privileged and Confidential



Scale 1:400,000
Alaska State Plane Zone 5 (units feet)
1983 North American Datum

File: RDI_ND_SPLAN1-1_11x17L_1of1.mxd	Date: June 28, 2004
Version: 1	Author: RDI-DWR

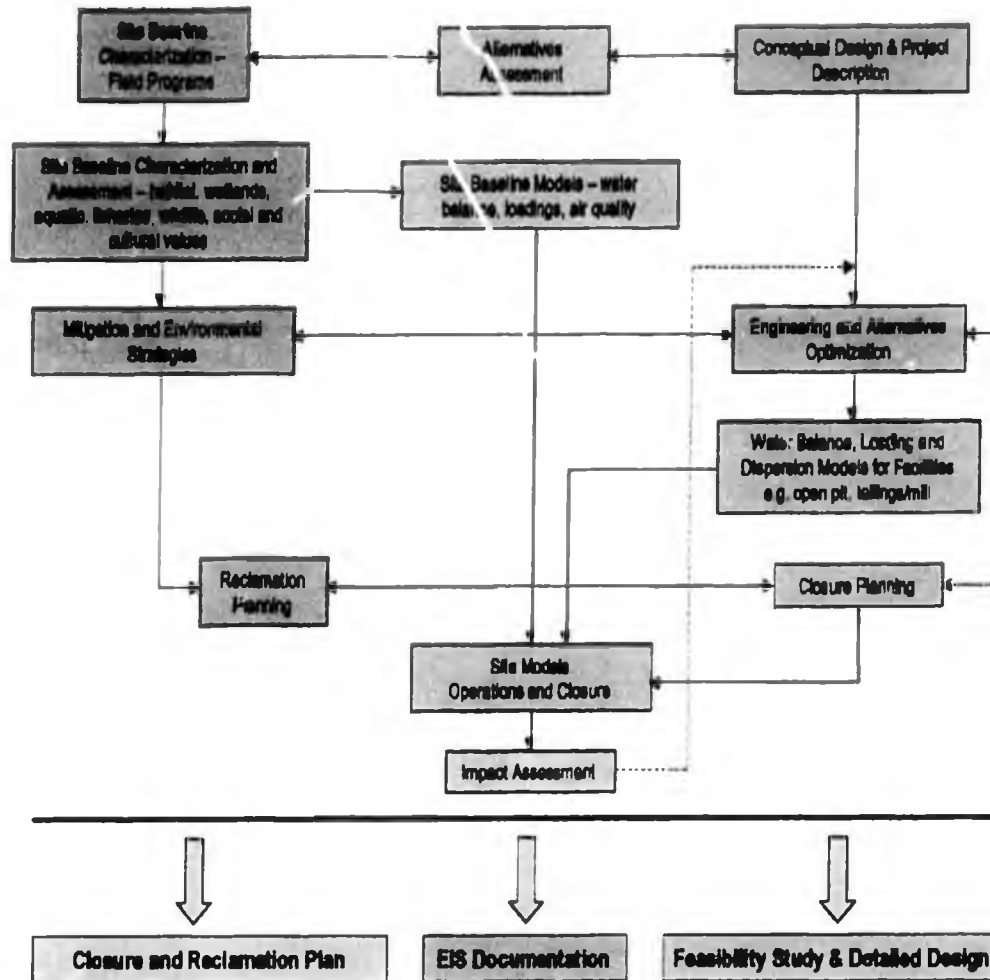




DRAFT

Pebble Project

Pebble Project Activity Flowsheet
Figure 1-2

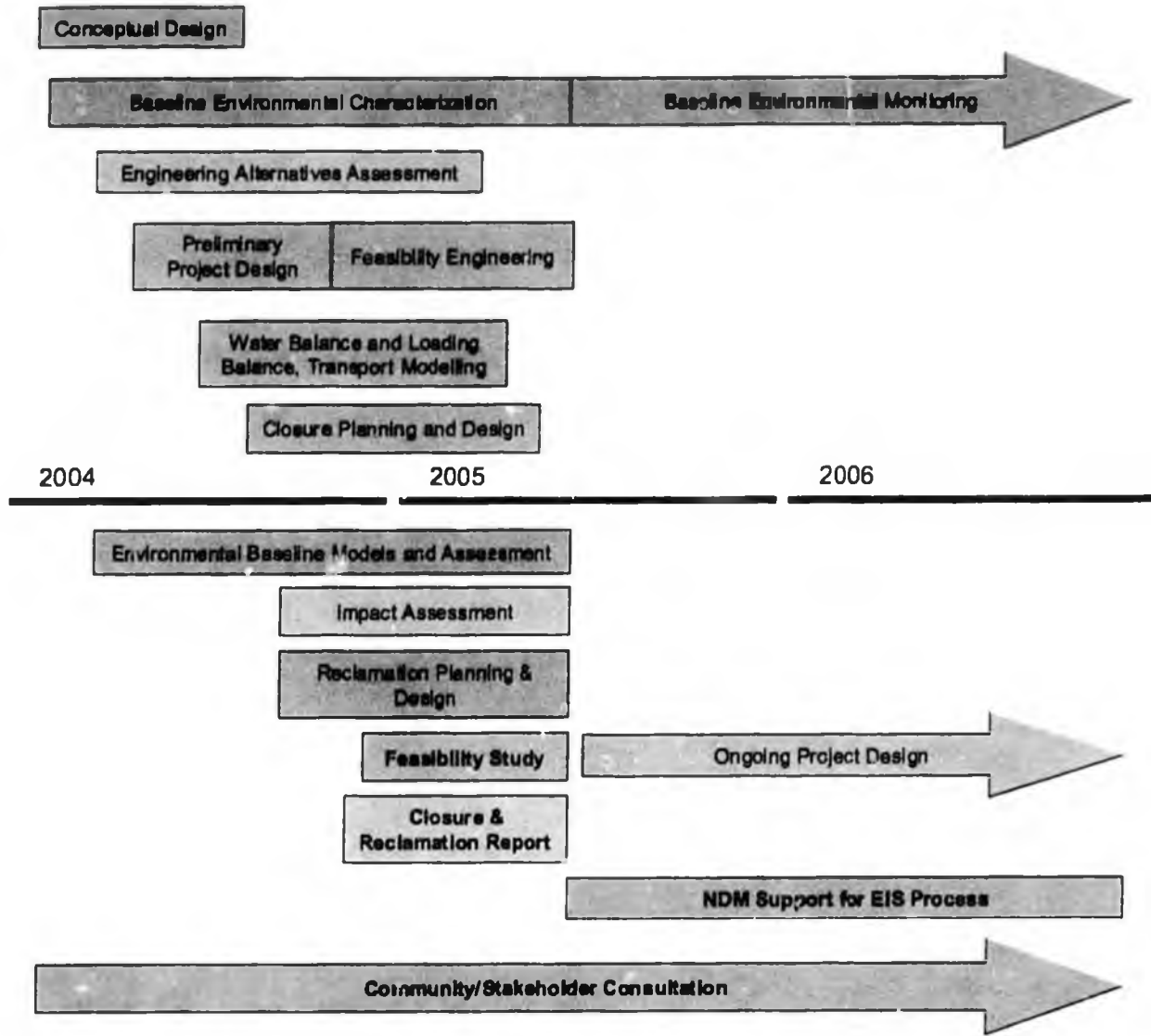




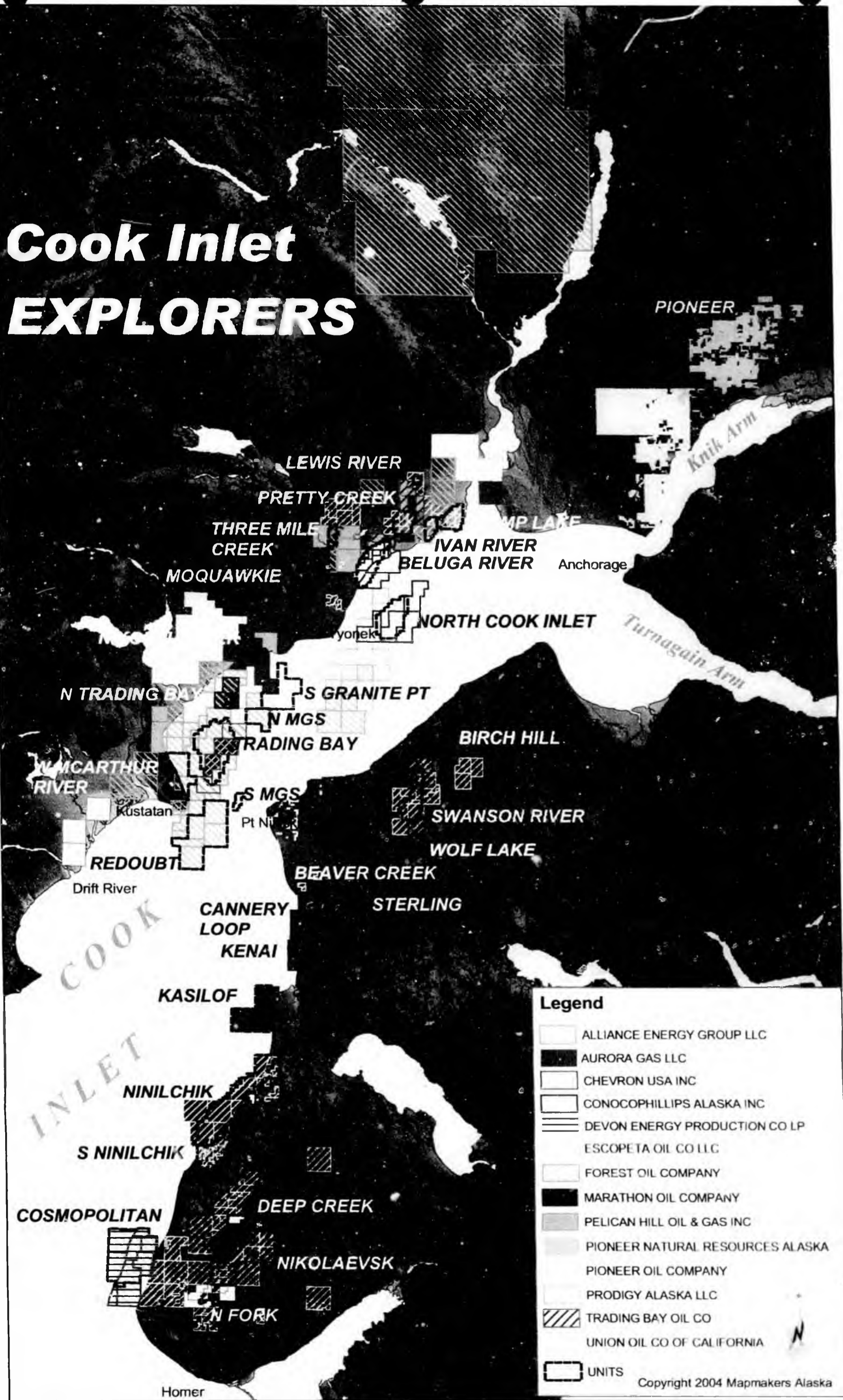
DRAFT

Pebble Project

Integration of Environmental and Engineering Activities
Figure 1-3



Cook Inlet EXPLORERS



Alaska Oil and Gas Conservation Commission (AOGCC)

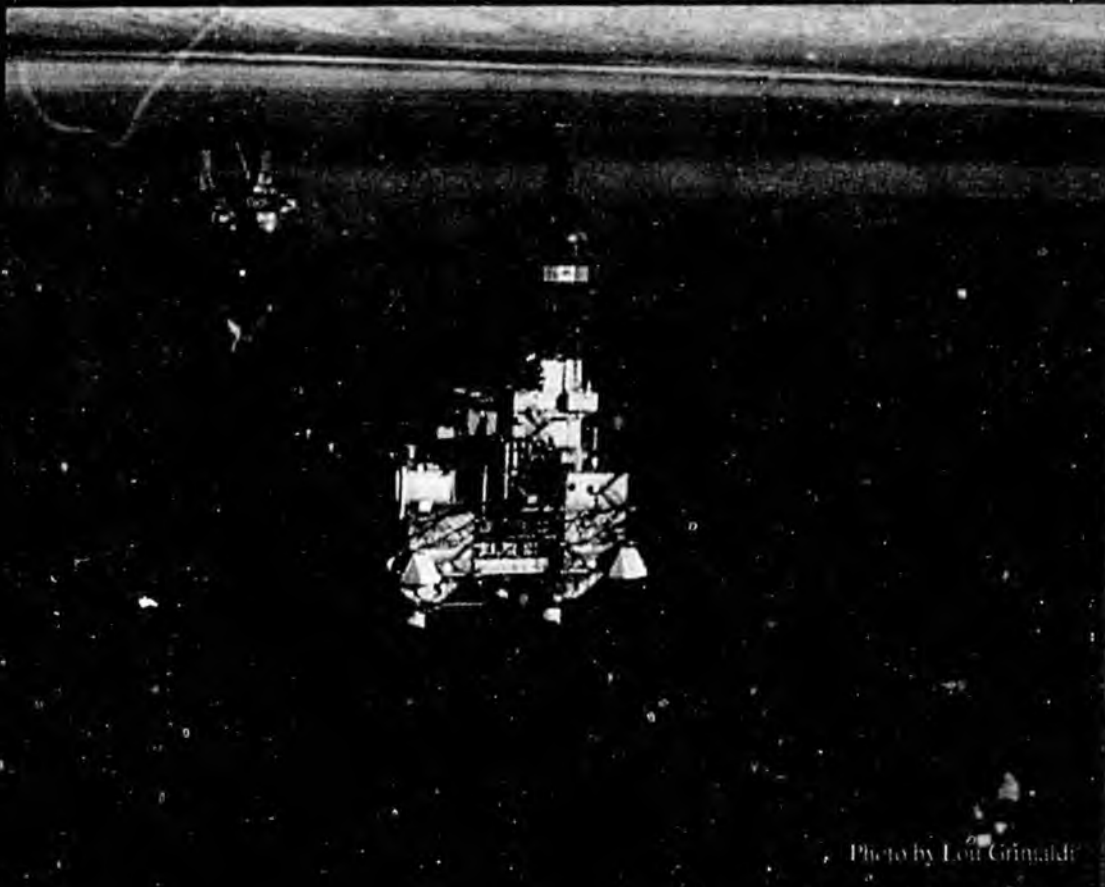


Photo by Lou Grimaldi



Cook Inlet Oil and Gas Conservation

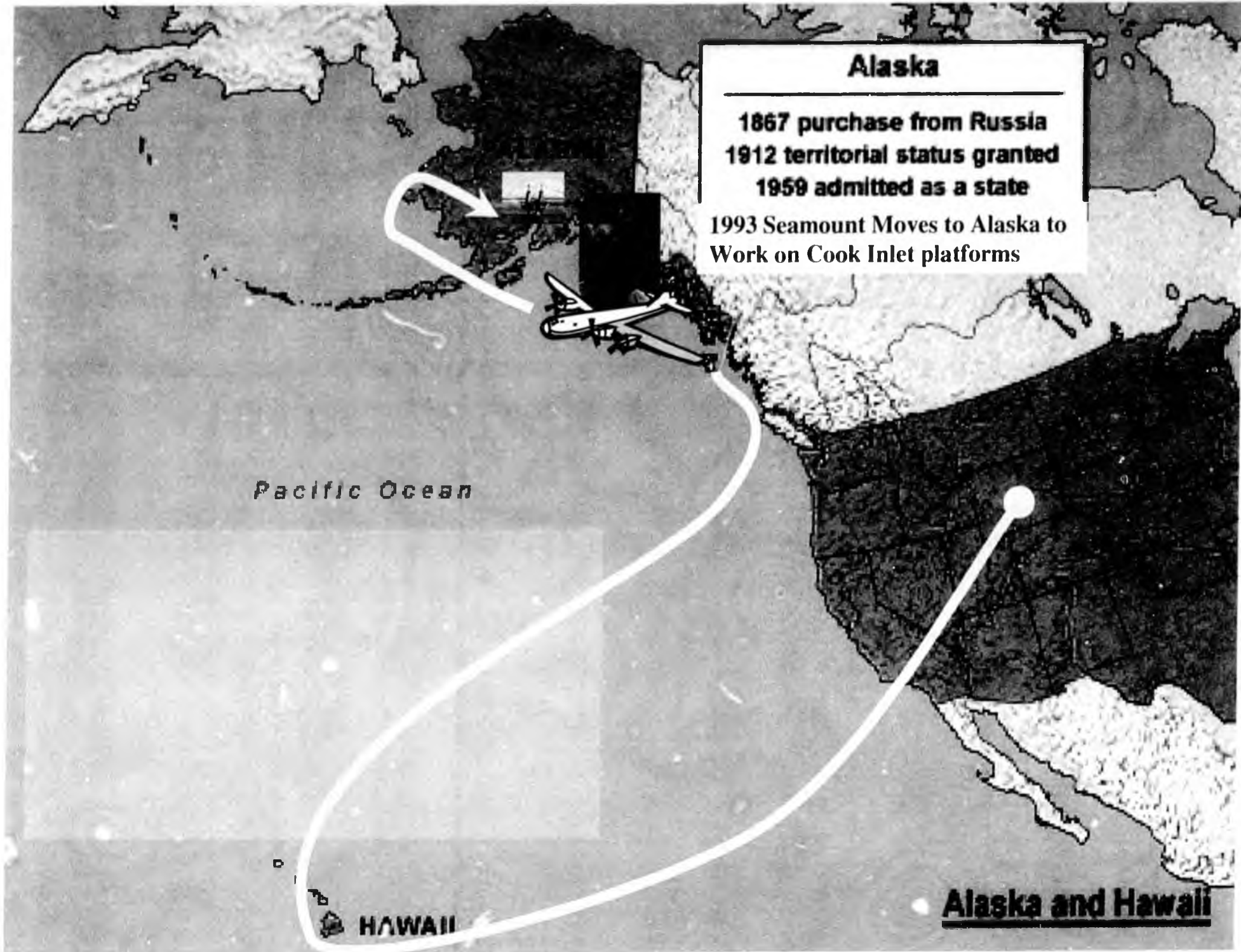
Presentation to Joint Senate & House
Resources Committee

by

Dan Seamunt, AOGCC
Commissioner

February 11, 2005

Presentation for Resources Committees, Kenai



Alaska

1867 purchase from Russia
1912 territorial status granted
1959 admitted as a state
1993 Seamount Moves to Alaska to
Work on Cook Inlet platforms

Pacific Ocean

HAWAII

Alaska and Hawaii

AOGCC and Future Cook Inlet

**AOGCC Authority, Oversight, and
Function**

Cook Inlet Oil & Gas Investors

**History of Offshore Cook Inlet Oil and
Gas**

Remaining Offshore Oil & Gas Resource

AOGCC Cook Inlet Wish List

Alaska Oil and Gas Conservation Commission (AOGCC)



Mission

Protect the public interest in oil and gas resources and protect underground supplies of drinking water.

The Oil and Gas Conservation Act requires conducting all oil and gas drilling, production and measuring operations to prevent physical resource waste, to promote greater ultimate recovery and to afford all owners of oil and gas rights an equal opportunity to recover their fair share of the resource:

Oversight

Quasi-judicial State regulatory agency- Mainly Sub-surface

Prevent physical waste of hydrocarbon resources

- Oversight for underground operations
- Regulate drilling and production for oil & gas

Promote greater ultimate recovery

Protect fresh water

- Manage Class II UIC program

Protect correlative rights

- Jurisdiction over private and public lands
- Adjudicate disputes between resource owners



Oversight Strategy

Regulatory & Adjudicatory

Statewide Regulations

- 20 AAC 25

Drilling and Sundry

Permits

Orders

- Conservation,
Injection, Aquifer
Exemption

Public Hearings

Compliance Reviews

Field Studies

Inspection

5 On-site Petroleum
Inspectors

Well Control Equipment

- Drilling and
Production

Metering

Well Integrity

Demonstrations

Visual Equipment

Checks

Incident Investigations

Other Inspections

OIL AND GAS OPERATORS AND OWNERS COOK INLET/MAT-SU VALLEY

- Unocal Alaska
- Forest Oil Corp.
- Marathon Oil Company
- Phillips Alaska Inc./ConocoPhillips
- XTO Energy Inc.
- Anadarko
- CIRI
- Aurora Gas LLC
- Northstar Energy Group Inc.
- Pelican Hill Oil & Gas Inc.
- Alaska Crude Corporation
- Frontier Petroleum
- Prodigy Oil & Gas LLC
- Escopeta
- Pioneer of Illinois

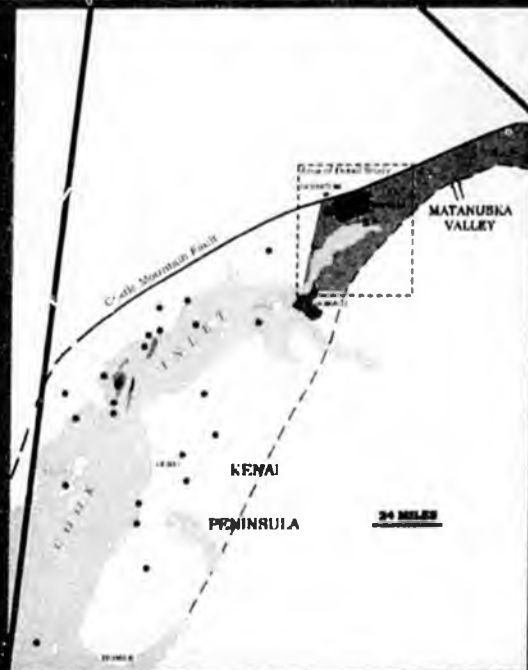


Grayling Platform

OTHER AREAS

- Pioneer Natural Resources AK Inc.
- Andex Resources LLC
- Cassandra Energy Corp
- Rutter & Wilbanks-
- Delphi International

Cook Inlet Exploration



Exploration Immaturity

Similar in size to
lower 48 Basins

14,000 sq mile Area
same as San Juan Basin

385 Exploration
Wells & 1000 Total
Wells

vs

28,000+ Wells in
San Juan

Presentation for Resources Committees, Kenai

No 80's Drilling Boom

Cook Inlet Basin Oil & Gas History

- 1950s & 1960s
 - Exploration in the Cook Inlet Basin began in the mid-1950s
 - 286 exploratory wells drilled (one well per 30 square miles in Basin)
 - 1.3 BBO discovered in 9 fields
 - 7.7 TCF of non-associated gas discovered in 19 fields

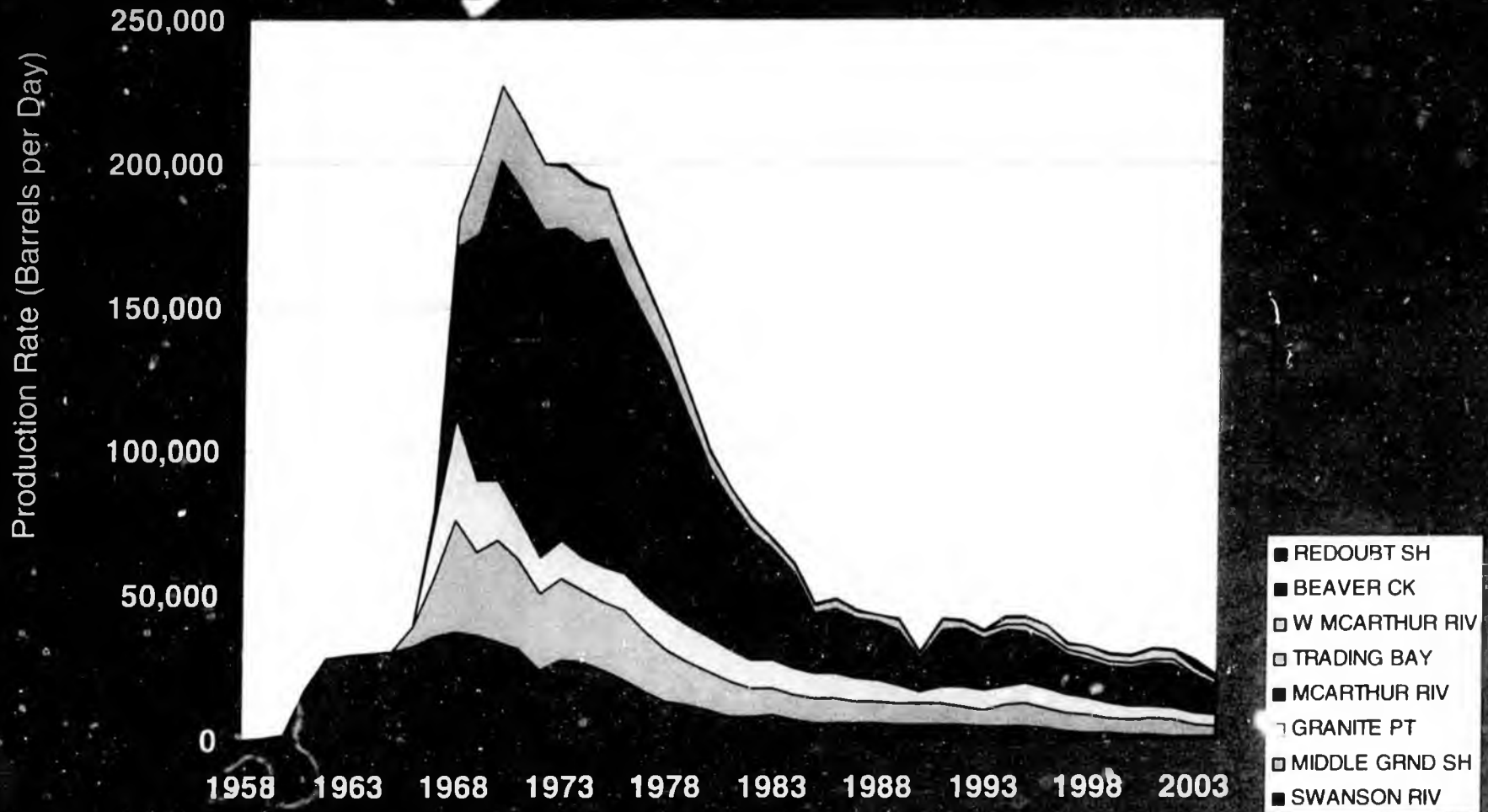
Cook Inlet Basin History

- 1970s & 1980s
 - Exploitation of early discoveries
 - Limited exploration (**never saw 80's Boom**)
- 1990s to present
 - Unocal attempts rescue of five platforms and prolongs their lives.
 - Very limited offshore exploratory drilling
 - Incentive legislation
 - XTO saves two platforms from coma by re-interpreting existing data
 - Redoubt Shoal



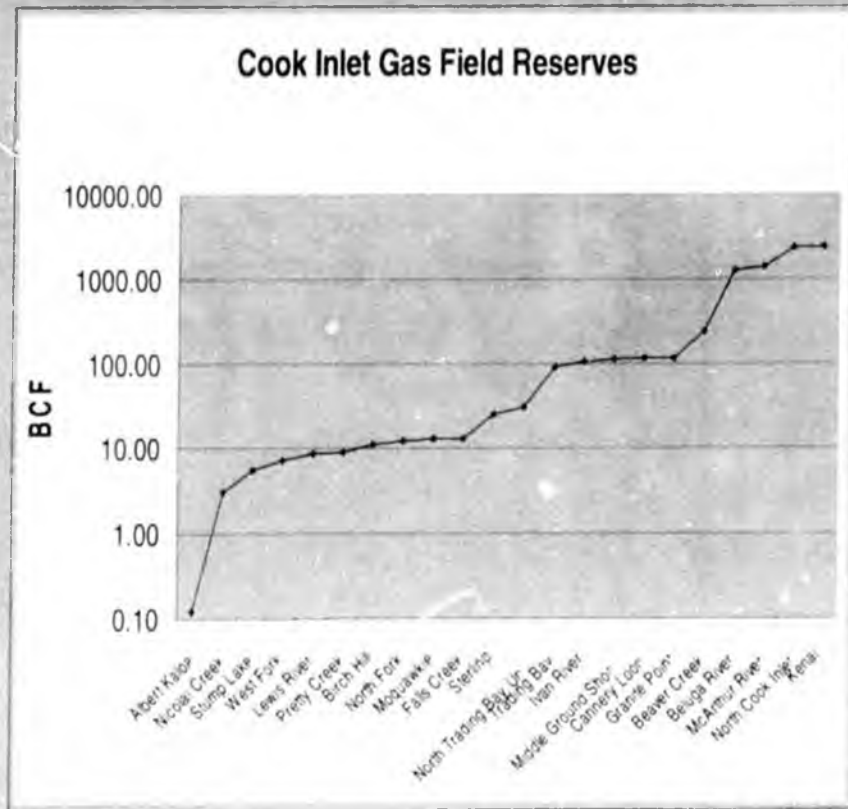
Bill Miller - XTO

COOK INLET DAILY OIL & NGL PRODUCTION RATE



Cook Inlet Cumulative Oil / NGL production – 3 Billion Barrels

Cook Inlet Gas



Field	BCF Gas
Albert Kaloa	0.1
Nicolai Creek	3.1
Stump Lake	5.6
West Fork	7.2
Lewis River	8.8
Pretty Creek	9.0
Birch Hill	11.1
North Fork	12.1
Moquawkie	13.0
Falls Creek	13.0
Sterling	25.5
North Trading Bay Unit	30.3
Trading Bay	89.7
Ivan River	104.3
Middle Ground Shoal	111.9
Cannery Loop	115.7
Granite Point	116.0
Beaver Creek	241.7
Beluga River	1266.3
McArthur River	1384.2
North Cook Inlet	2327.9
Kenai	2425.1

Preparation for Resources Committee, Kenai

Total

8321.60

AOGCC and Future Cook Inlet

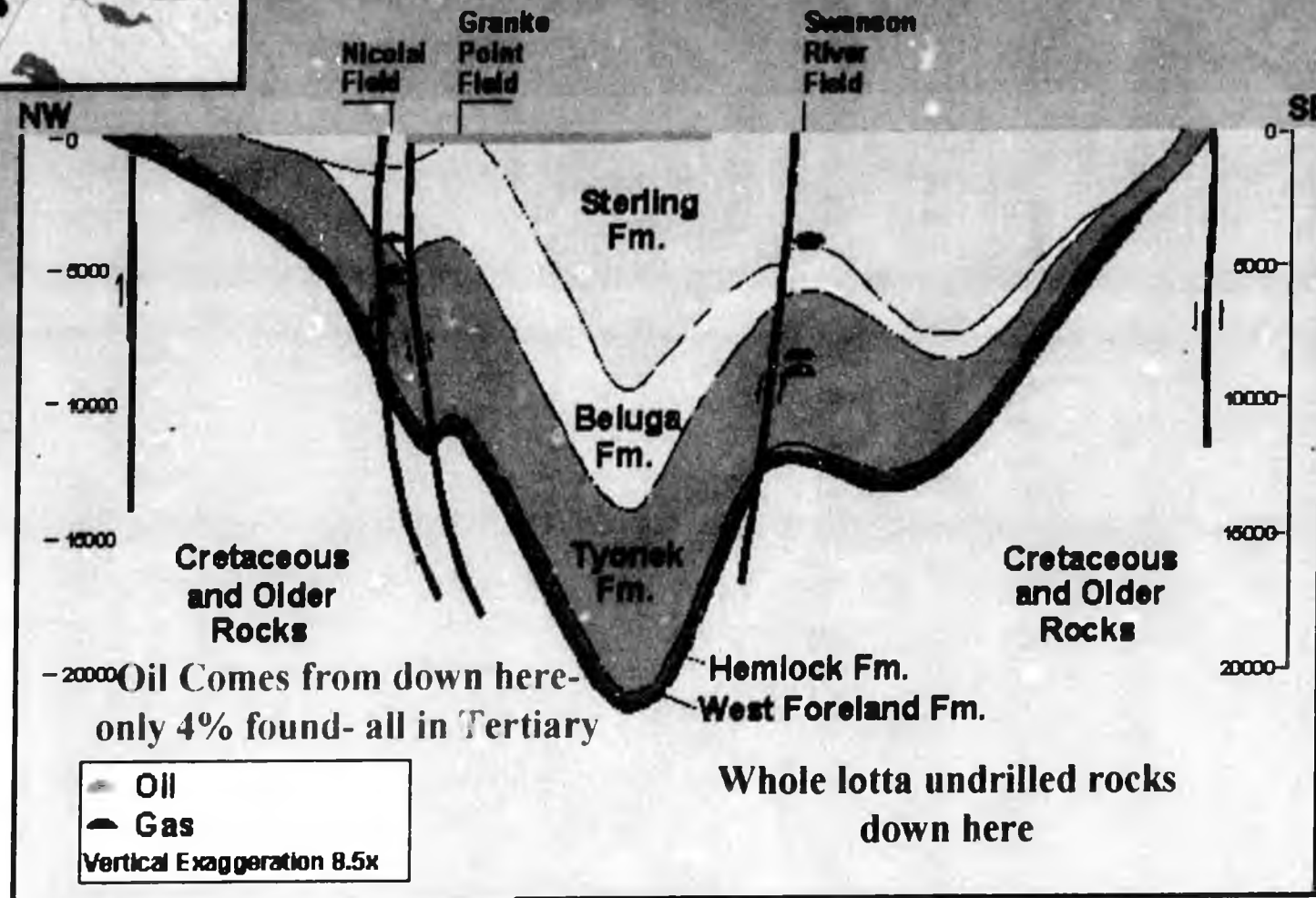
Remaining Offshore Oil & Gas Resource

- Un-recovered oil in Known Pools- low risk with new technology/oil price
- Undeveloped Fault Blocks- mod risk/mod potential
- Pre-Tertiary- high risk/high potential
- Other Identified Prospects accessible from Platforms- see industry



Cook Inlet Basin

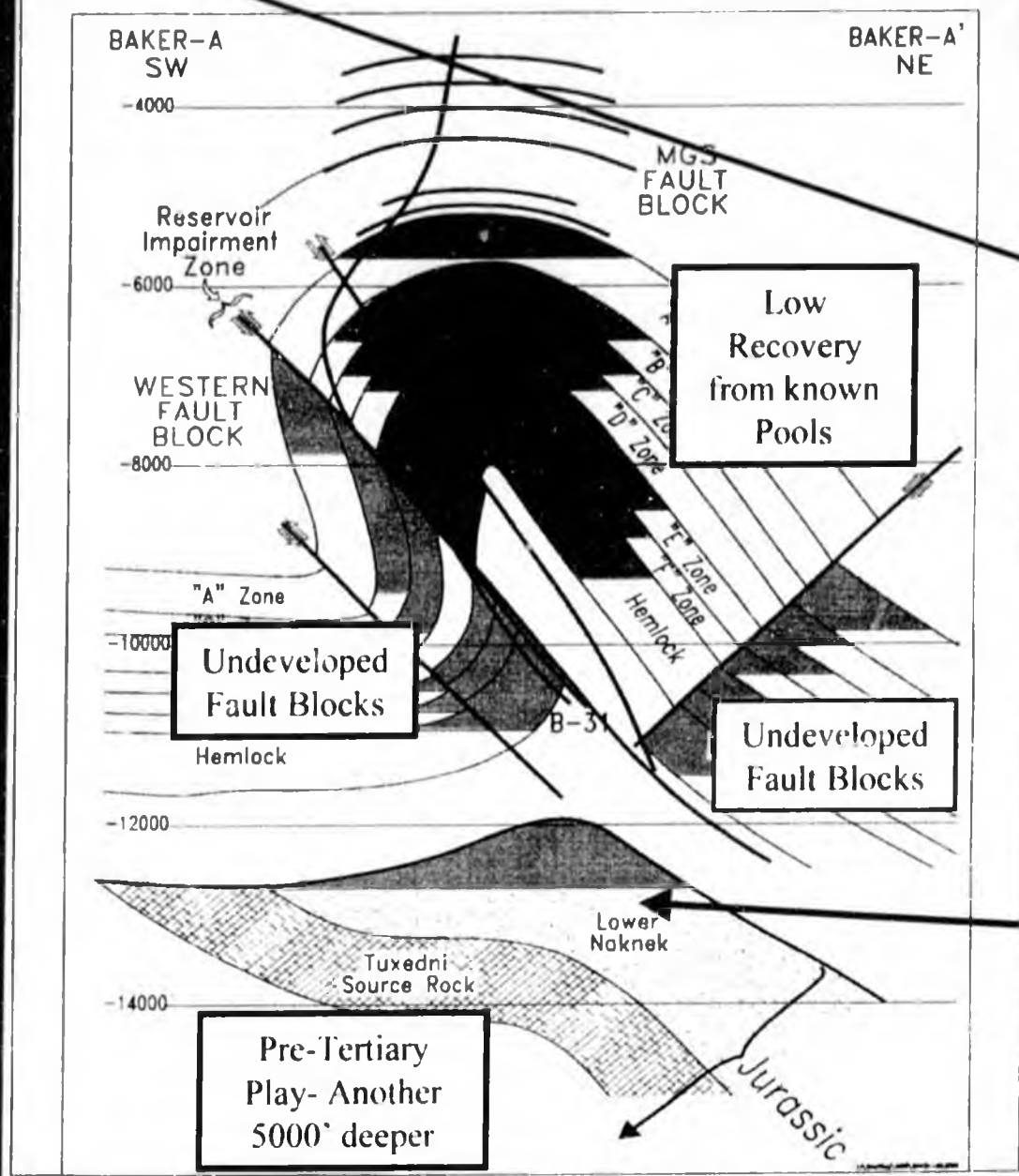
Generalized Geologic Cross Section



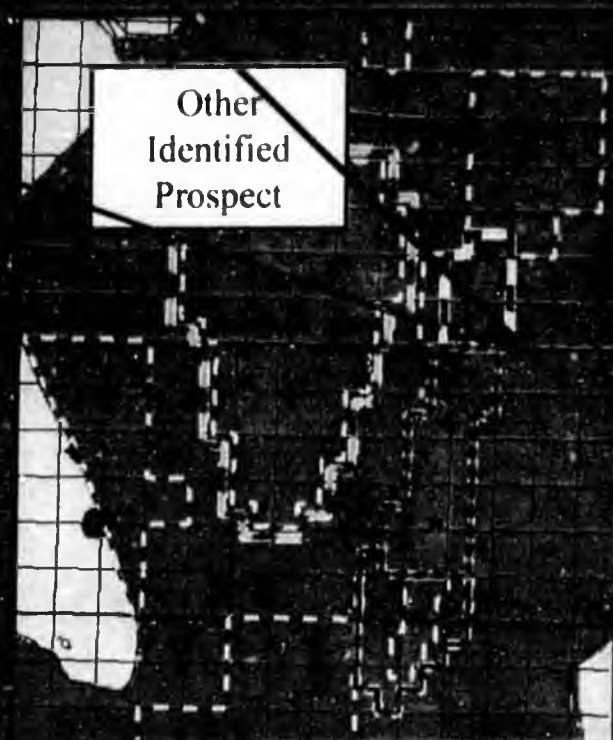
Less than 55 wells have penetrated the entire tertiary section. Oil is generated deeper where no wells have boldly gone before.

mep 98

NORTH MIDDLE GROUND SHOAL

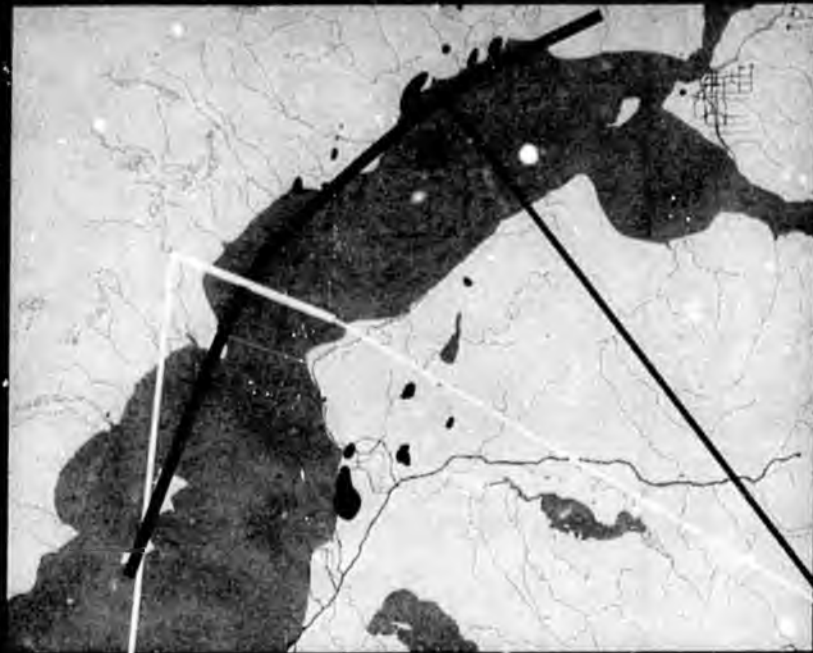


Jurassic Closure at MGS Field

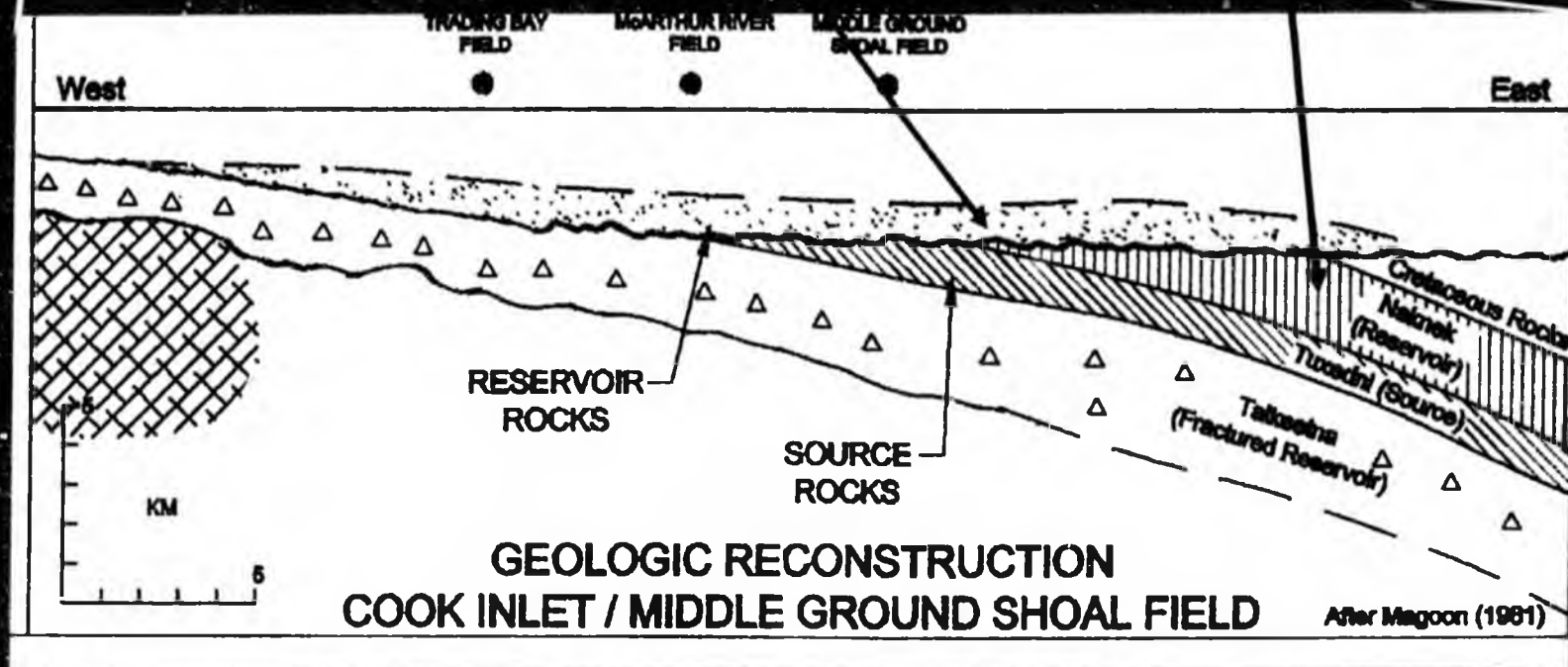


Both porous Naknek and fractured Jurassic can be targeted where Naknek is present

Pre-Tertiary Subcrop Play *Upper Cook Inlet Basin*



Naknek is immediately
above Tuxedni



AOGCC Cook Inlet Offshore Reality

Majors had a 40 year run at the offshore
Four of 16 platforms have been "light housed"
Operators can't be forced to continue
Much liability may exist for operators
Many new potential investors have arrived.
Much oil is left in the developed reservoirs
Many exploration prospects exist within reach
of the platforms
High \$\$\$ Oil Price

AOGCC Cook Inlet Offshore Wishlist

Look at Platforms as Assets/ don't destroy

Recover More Oil from Developed Reservoirs

- Sell to motivated low cost operator?
- State takes possession/ protection of former operators
- Tertiary oil recovery and/or stimulations?



Photo by Lou Gimaldi.

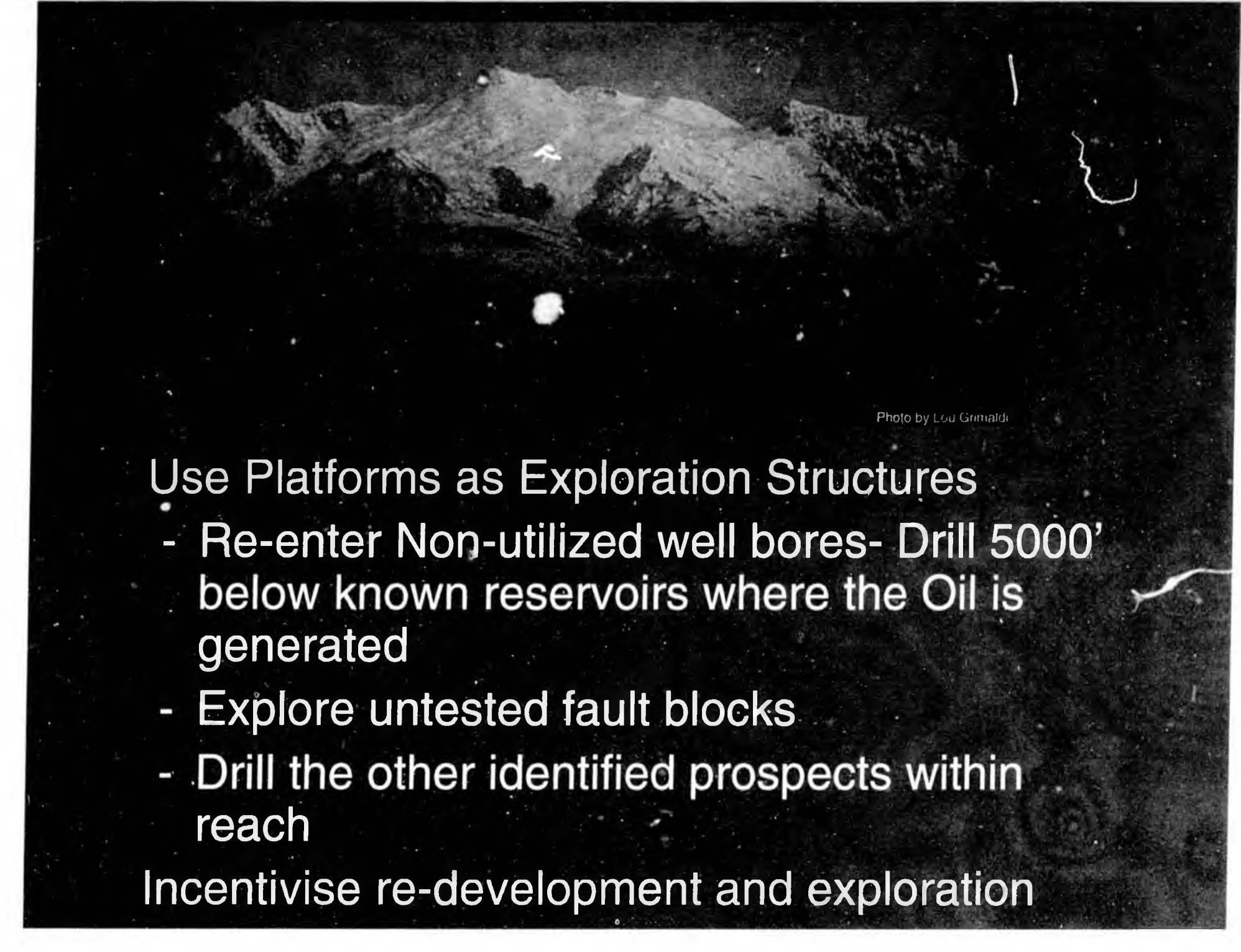
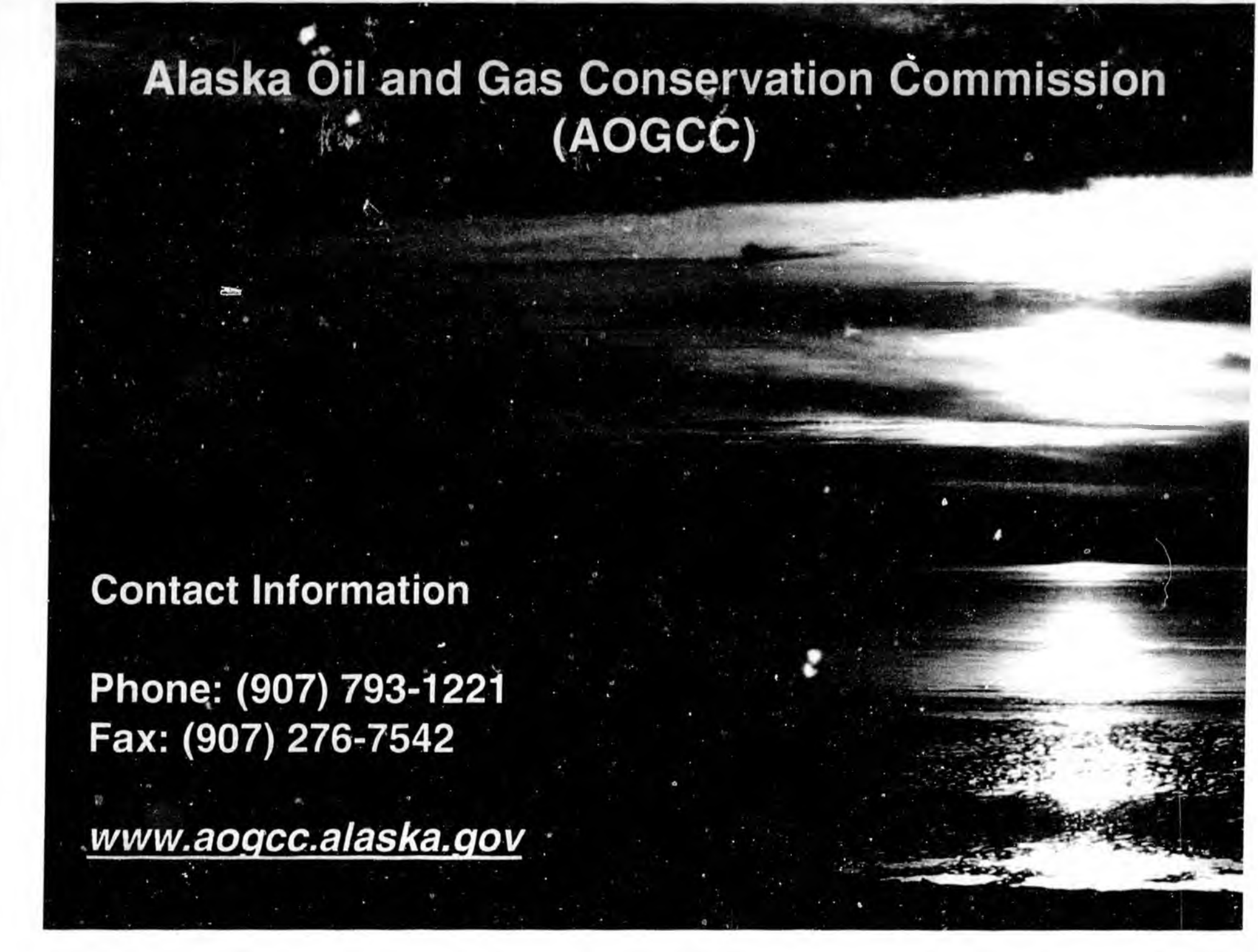


Photo by Lou Girmaldi

Use Platforms as Exploration Structures

- Re-enter Non-utilized well bores- Drill 5000' below known reservoirs where the Oil is generated
- Explore untested fault blocks
- Drill the other identified prospects within reach

Incentivise re-development and exploration



**Alaska Oil and Gas Conservation Commission
(AOGCC)**

Contact Information

Phone: (907) 793-1221

Fax: (907) 276-7542

www.aogcc.alaska.gov



Official Business

ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

- Co-Chair, Senate Transportation Committee
- Vice-Chair, Senate Resources Committee
- Vice-Chair, Community & Regional Affairs
- Member, Legislative Council

Session: January – May

State Capitol, #427

Juneau, AK 99801

Phone: 907-465-2828 Fax: 907-465-4779

Interim: May – December

145 Main Street Loop; Suite 226

Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Mike Stophlet, President & CEO
ASRC Energy Services
3900 C St., Suite 701
Anchorage, AK 99503

Dear Mr. Stophlet;

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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If you wish to participate, please advise my office as soon as is possible; please contact my Resources Committee staff, Mary Jackson, at 465-4907 or fax me at 465-4779.

Thank you for your time and consideration.

Sincerely,

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Senate Resources Committee

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February 2, 2005

James Udelhoven, CEO
Udelhoven Oilfield System Services, Inc.
184 E. 53rd Ave.
Anchorage, AK 99518-1222

Dear Mr. Udelhoven;

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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hone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Pete Leathard, President
VECO Corporation
3601 C Street, Suite 1000
Anchorage, AK 99503

Dear Mr. Leathard:

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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Senate Resources Committee

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Kenai Peninsula Borough Mayor Dale Bagley



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February 2, 2005

Don Jones, CEO
Pioneer Oil Company
Highway 50 & Airport Road, RR 4 Box 142B
Lawrenceville, IL 62439

Dear Mr. Jones:

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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February 2, 2005

Allen Gross, President
Pelican Hill Oil & Gas, Inc.
1401 N. El Camino Road, Suite 207
San Clemente, CA 92672

Dear Mr. Gross;

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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hone: 907-283-7996 Fax 907--283-8127

February 2, 2005

Danny Davis, President
Escopeta Oil & Gas/SBI
5005 Riverway #440
Houston, TX 77056

Dear Mr. Davis;

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Kenai, AK 99611
Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Rodney Cason, President
Tesoro Alaska Company
P.O. Box 3369
Kenai, AK 99611

Dear Mr. Cason;

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February 2, 2005

Shawn Bartholomae, President & CEO
Prodigy Oil & Gas, LLC
433 E. Las Colinas Blvd., Suite 800
Irving, TX 75039

Dear Mr. Bartholomae;

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Kenai Peninsula Borough Mayor Dale Bagley



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Interim: May - December

145 Main Street Loop; Suite 226

Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Margie Brown, President & CEO

CIRI

P.O. Box 93330

Anchorage, AK 99509-3330

Dear Ms. Brown:

In December, I sent a letter regarding a Joint Senate & House Resource Committee meeting on Friday, February 11, 2005, on the Kenai Peninsula, to receive input from businesses that are active in the Cook Inlet. I have not received a response from you and so am following up with this letter, in case the previous correspondence was inadvertently lost or misplaced.

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Kenai Peninsula Borough Mayor Dale Bagley



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Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Bill Boycott, Manager, Kenai Nitrogen Operations
Agrium
P.O. Box 575
Kenai, AK 99611-0575

Dear Mr. Boycott:

Thank you for agreeing to speak to the Joint Senate & House Resource Committee meeting on Friday, February 11, 2005.

To reiterate my original request, I am asking for a 10 to 15-minute presentation by each party, followed by questions from committee members. The presentation should focus on matters you believe are necessary to work in Cook Inlet; issues like credits for deep drilling, capital reinvestment credits, exploration credits for jack up rigs, regulatory revisions, infrastructure needs, labor needs, and so forth.

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Thank you for agreeing to participate and I look forward to your presentation.

Sincerely,

A handwritten signature in cursive script, appearing to read "Tom Wagoner".

Senator Tom Wagoner, Chair
Senate Resources Committee

cc: Representative Ralph Samuels, Co-Chair House Resources, 24th Alaska Legislature
Representative-Elect Jay Ramras, Co-Chair House Resources, 24th Alaska Legislature
Kenai Peninsula Borough Mayor Dale Bagley



Official Business

ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

- Co-Chair, Senate Transportation Committee
- Vice-Chair, Senate Resources Committee
- Vice-Chair, Community & Regional Affairs
- Member, Legislative Council

Session: January - May
State Capitol, #427
Juneau, AK 99801
Phone: 907-465-2828 Fax: 907-465-4779

Interim: May - December
145 Main Street Loop, Suite 226
Kenai, AK 99611
Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Scott Pfoff, President
Aurora
10333 Richmond Ave., Suite 710
Houston, TX 77042

Dear Mr. Pfoff:

Thank you for agreeing to speak to the Joint Senate & House Resource Committee meeting on Friday, February 11, 2005.

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Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

Charles Pierce, Vice President
Unocal Alaska
P.O. Box 196247
Anchorage, AK 99519-6247

Dear Mr. Pierce:

Thank you for agreeing to speak to the Joint Senate & House Resource Committee meeting on Friday, February 11, 2005.

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Kenai Peninsula Borough Mayor Dale Bagley



Official Business

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Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

John Barnes, Alaska Business Unit Manager
Marathon Oil Company
Box 196168
Anchorage, AK 99519-6168

Dear Mr. Barnes:

Thank you for agreeing to speak to the Joint Senate & House Resource Committee meeting on Friday, February 11, 2005.

To reiterate my original request, I am asking for a 10 to 15-minute presentation by each party, followed by questions from committee members. The presentation should focus on matters you believe are necessary to work in Cook Inlet; issues like credits for deep drilling, capital reinvestment credits, exploration credits for jack up rigs, regulatory revisions, infrastructure needs, labor needs, and so forth.

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xc: Representative Ralph Samuels, Co-Chair House Resources, 24th Alaska Legislature
Representative-Elect Jay Ramras, Co-Chair House Resources, 24th Alaska Legislature
Kenai Peninsula Borough Mayor Dale Bagley



Official Business

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145 Main Street Loop; Suite 226

Kenai, AK 99611

Phone: 907-283-7996 Fax 907-283-8127

February 2, 2005

James Bowles, President
ConocoPhillips Alaska, Inc.
PO Box 100360
Anchorage, AK 99510-0360

Dear Mr. Bowles;

Thank you for agreeing to speak to the Joint Senate & House Resource Committee meeting on Friday, February 11, 2005.

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Representative-Elect Jay Ramras, Co-Chair House Resources, 24th Alaska Legislature
Kenai Peninsula Borough Mayor Dale Bagley

ALASKA LEGISLATURE - ONLINE TELECONFERENCE ORDER FORM

Note: All Fields Must Be Completed

Sponsor and/or Committee Name:

Date of Teleconference:

Start Time: End Time:

Chairing Site: Juneau Room:

- | | | | |
|------------|--|-----------------------|--|
| Testimony: | <input type="radio"/> Yes | Testimony Time Limit: | <input type="radio"/> 1 min |
| | <input type="radio"/> No | | <input type="radio"/> 2 min |
| | <input checked="" type="radio"/> Invitation Only | | <input type="radio"/> 3 min |
| | <input type="radio"/> N/A | | <input type="radio"/> 5 min |
| | | | <input checked="" type="radio"/> no time limit |
| | | | <input type="radio"/> other - see instructions |

Contact Person

Telephone Number

- | | | | | |
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| LIO sites: | <input checked="" type="checkbox"/> Anchorage | Other sites | <input checked="" type="radio"/> Yes | Offnet Name (s) |
| | <input type="checkbox"/> Barrow | may add? | <input type="radio"/> No | |
| | <input type="checkbox"/> Bethel | | | |
| | <input type="checkbox"/> Cordova | | | |
| | <input type="checkbox"/> Delta Junction | | | |
| | <input type="checkbox"/> Dillingham | | | |
| | <input type="checkbox"/> Fairbanks | | | |
| | <input type="checkbox"/> Glennallen | | | |
| | <input type="checkbox"/> Homer | | | |
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| <input type="checkbox"/> Valdez | | | | |
| <input type="checkbox"/> Wrangell | | | | |

i expect there will be some offnets but probably as a listen only.

No LIOs

Subject of meeting and/or Bills on Agenda

Presentation by Cook Inlet Industry Representatives

The meeting will consist of multiple presentations to the Joint Committee by industries working in the Cook Inlet.

Agrium

Kenai Nitrogen Operations

July 2004



Summary of

Alaskan Direct Economic Impacts

"By Alaska economic standards, the Agrium operation is exceptional for its combination of high pay levels, amount and concentration of expenditures in the local area, and the degree of value added manufacturing that occurs in Alaska prior to export. The result is a high multiplier impact."

- McDowell Group, October 2002

A recent study completed by the McDowell Group in April 2004 identified the following direct impacts of Agrium's Kenai Nitrogen Operations:

- ✓ Agrium spent \$101 million in Alaska in 2003
- ✓ \$77 million in purchases of goods and services from 384 Alaskan businesses
- ✓ \$22.0 million in direct payroll; including benefits, expenditures are \$29.5 million
- ✓ \$2.2 million in taxes and lease payments
- ✓ \$195,000 in charitable donations to 43 non-profit organizations and groups

Summary of

Alaskan Indirect Economic Benefits

For every one thousand cubic feet of Cook Inlet natural gas used by Agrium for feedstock and power generation, \$9.35 in total economic output is generated.

- ✓ Agrium employees have 244 school age dependents or about 2.5 percent of the Central Peninsula student enrollment
- ✓ Agrium's total direct, indirect, and induced payroll impacts support 7.0 percent of the total Kenai Peninsula payroll
- ✓ Agrium total direct, indirect, and induced employment accounts for 4.0 percent of the total employment on the Kenai Peninsula

Did You Know?

- ✓ Agrium is the Kenai Peninsula's fourth largest private employer with an average employment of 230 people
- ✓ Agrium accounts for an additional 420 jobs in Alaska and the Kenai Peninsula Borough
- ✓ Agrium direct expenditures on the Kenai amounted to \$65 million in 2003 on goods and services provided by 320 Kenai Peninsula companies
- ✓ Agrium donations to local school and youth activities accounted for 54% of the company's charitable donations
- ✓ Agrium's Kenai Nitrogen Operations is the second largest nitrogen production complex in the U.S.A.
- ✓ Agrium's Kenai Nitrogen Operations accounts for about 6 percent of North America's nitrogen production
- ✓ In 2003, Agrium's Kenai Nitrogen Operations exported 1.2 million tons of ammonia and urea valued at \$200 million
- ✓ Agrium's Kenai Nitrogen Operations is one of Alaska's few value added industries

Agrium

kenai

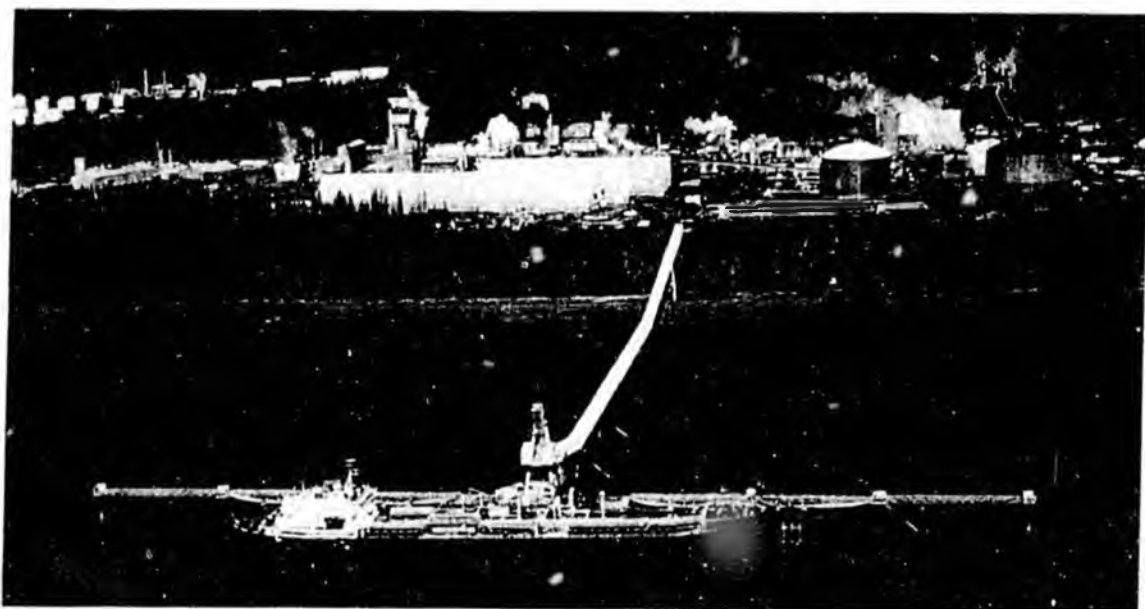
nitrogen

Agrium Inc. produces more than 11 million tons (10 million tonnes) of fertilizers annually. Nitrogen fertilizer products account for some 8.2 million tons (7.5 million tonnes) of that total. Potash fertilizers account for 1.7 million tons (1.5 million tonnes) and phosphate fertilizers for 1.1 million tons (1 million tonnes).

Agrium is also one of the largest agricultural retailers in the United States, supplying products and related services to growers in 24 states under the retail banners of Crop Production Services and Western Farm Service. We are also a leading fertilizer retailer in Argentina, with outlets operating under the trade name Agroservicios Pampeanos.

Agrium's commitment to the communities where we operate is actively demonstrated through open and honest communications, responsible environmental stewardship, putting safety first and by investing in a bright tomorrow.

From our
facilities in
North and
South America,
more than 5,000
Agrium employees
supply growers
around the world
with fertilizers
to sustain the
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safe food for
millions of
people.



K

Agrium

Fertilizer Products

It is estimated that 50 percent of the food production in North America is the direct result of nitrogen-based fertilization. Nitrogen is the plant nutrient most commonly deficient in western agriculture. The ammonia and urea fertilizers produced at Kenai Nitrogen Operations play a major role in promoting high yields of nutritious food crops. Without them, not only would food prices rise, but food quality would also diminish.



*Anhydrous
Ammonia*



Urea

○ Hydrogen

○ Nitrogen

○ Carbon

○ Oxygen

Ammonia and urea are found in nature. Without them, life as we know it would not be possible. Ammonia is a vital part of every living cell, and urea is a natural byproduct of the breakdown of protein in the digestive system.

In terms of their nutrient content, the nitrogen fertilizer products produced at Kenai Nitrogen Operations are identical to 'organic' fertilizers. The source of plant nutrients is irrelevant to the yield or quality of the fruit, grain or vegetable matter produced by the plant.

Anhydrous ammonia is a liquid fertilizer, manufactured by combining nitrogen gases from the atmosphere with hydrogen derived from natural gas and water. The natural gas reacts with superheated steam (between 1300°F (700°C) and 1400°F (760°C)) in the presence of a catalyst to separate hydrogen, from the natural gas, reacts with nitrogen from the atmosphere to form anhydrous ammonia. The word "anhydrous" simply means "without water."

Urea is a solid fertilizer, made by reacting carbon dioxide and ammonia under extreme pressure at 375°F (190°C). The resulting molten mixture is then processed into small, white, crystalline spheres, called prills or granules. Urea is the major fertilizer traded in international commerce, accounting for approximately 50 percent of the nitrogen fertilizer traded around the world.

Ammonia and urea are also used in many other applications including cattle feed, paper, synthetic fibers, resins, refrigeration, waste treatment, rocket propellants, household cleaners, even medicines.

kenai

nitrogen

Environmental Stewardship

We are continually working to reduce the environmental impact of our operations. Complying with state and federal environmental regulations is just a beginning. Environmental considerations are a part of all our business decisions.

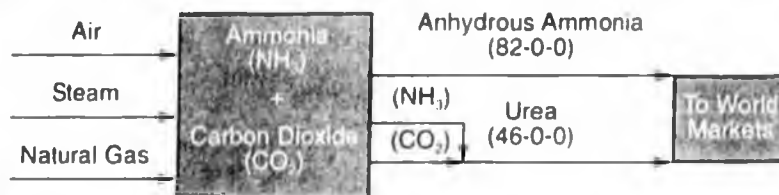
Our environmental protection begins with the safety of our employees. Everyone benefits from having a safe workplace, which comes from careful attention to safe operating procedures, emergency preparedness and preventative maintenance. These practices reduce the potential for plant upsets which could impact the environment.

Since 1996 we have reduced hazardous waste generation at the plant by 99 percent. We accomplished this by replacing a process solution that produced a hazardous byproduct with one that generates no waste, and by replacing solvent and caustic dip tanks with part washers that use hot water and soap.

We have an aggressive pollution prevention plan, and continually look for opportunities to reduce waste volume and toxicity. Our waste minimization efforts have received praise from the Alaska Department of Environmental Conservation and have been recognized by Alaska's Green Star Program.

We continually implement efficiency improvements to reduce atmospheric emissions and burn less fossil fuel. In spring, 2001, the start-up of an electric cogeneration facility eliminated more than 500 tons (455 tonnes) per year of nitrogen oxide emissions.

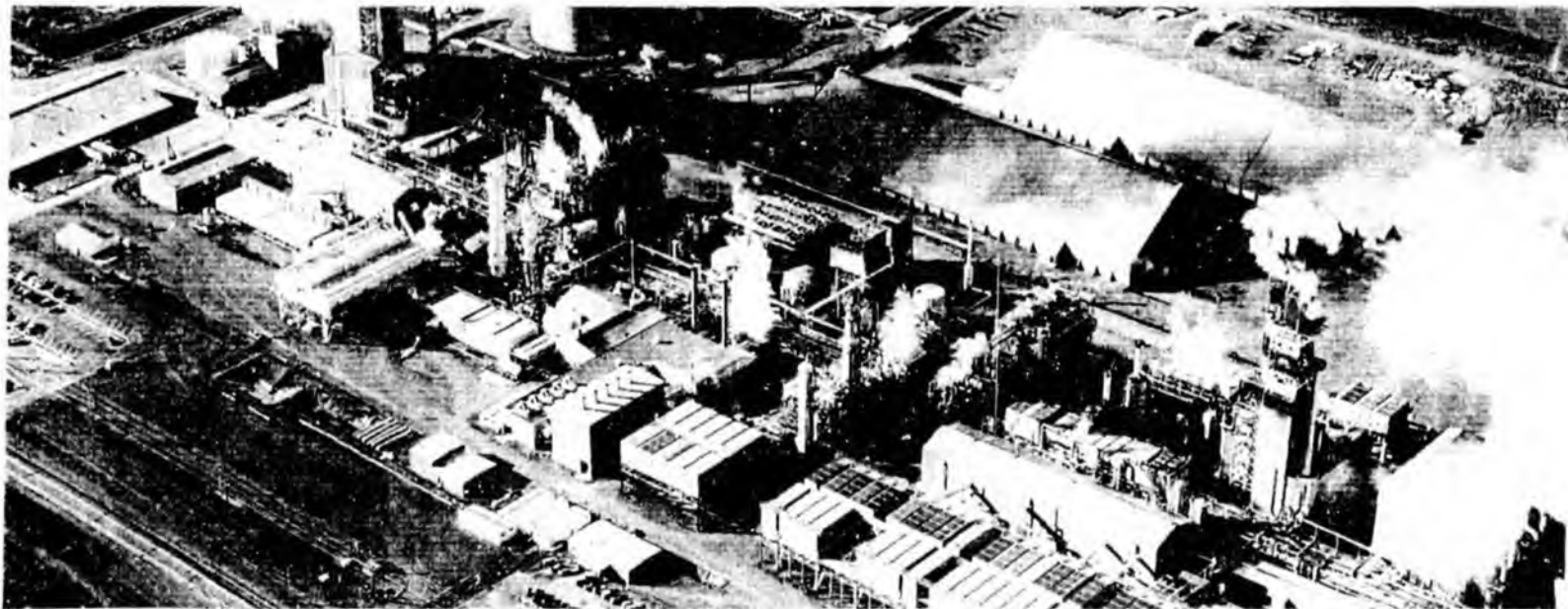
Raw Materials and Products



Best Management Practices

To ensure that our customers always receive safe, competitively-priced products, Agrum is committed to best management practices in the production, distribution and use of everything we make. For the grower, getting the best value for every dollar spent on crop production is more important today than ever before.

The proper use of Agrum anhydrous ammonia and urea fits well into Best Management Practices. The fertilizers produced at the Kenai plant are an effective aid in helping growers achieve maximum efficiency while minimizing environmental impact.



Impact on Local Economy

The Kenai Operation provides employment for more than 230 full time employees who earn approximately \$20 million in wages and benefits. In 2001, Agrium spent \$95 million to buy local goods and services from 250 Alaskan businesses and paid \$2.5 million in taxes and lease payments.

Caring for the Kenai

We also are proud to sponsor the nationally acclaimed Caring for the Kenai environmental awareness contest that annually challenges local high school students to answer the question: "What can I do, create, invent or improve to better care for the environment of the Kenai Peninsula?" The program has not only raised the level of environmental awareness on the Kenai, but has also generated many practical ideas that have improved our environment.

In April, 2001, President George W. Bush honored Kenai Peninsula youth by presenting a President's Environmental Youth Award to three young people who had participated in our "Caring for the Kenai" environmental awareness program. In return, the students gave the President a "Caring for the Kenai" jacket.



Partners in the Community

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Kenai Nitrogen Operations is a strong supporter of the United Way, with employee donations matched dollar for dollar by the Company. And we are active volunteers on business and professional organizations as well as government boards and commissions. In 2001, Agrium donated \$140,000 to 87 non-profit organizations and groups.

Agrium

Kenai
Nitrogen Operations

P.O. Box 575,
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Kenai, Alaska
99611

Phone: (907) 776-8121
Fax: (907) 778-5579

<http://www.agrium.com>

PUBLISHED 1201
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Agrium

kenai

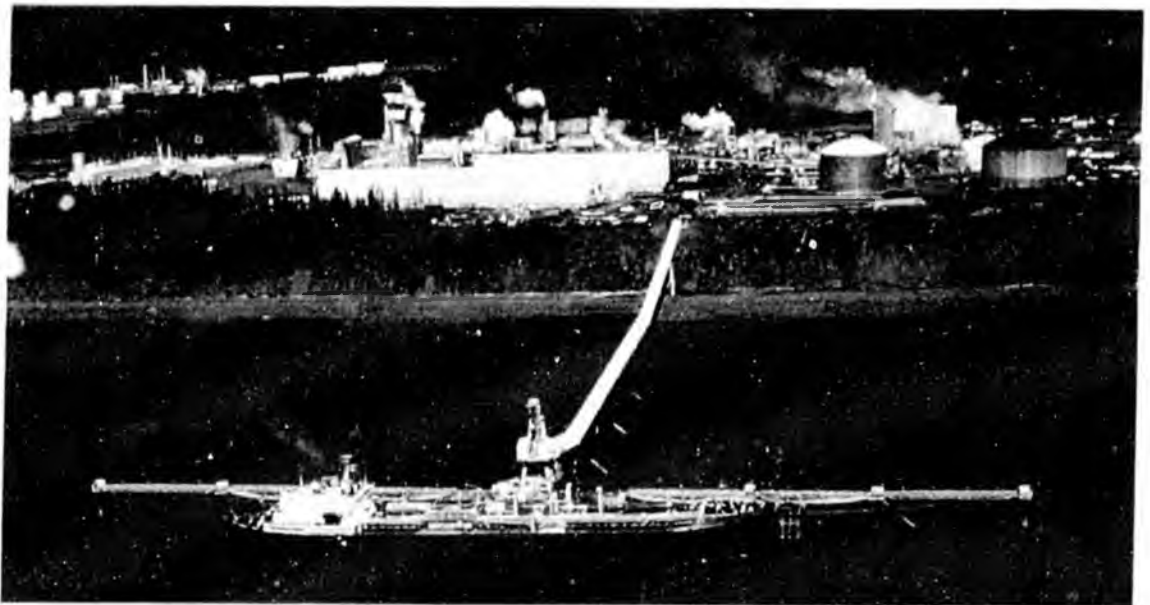
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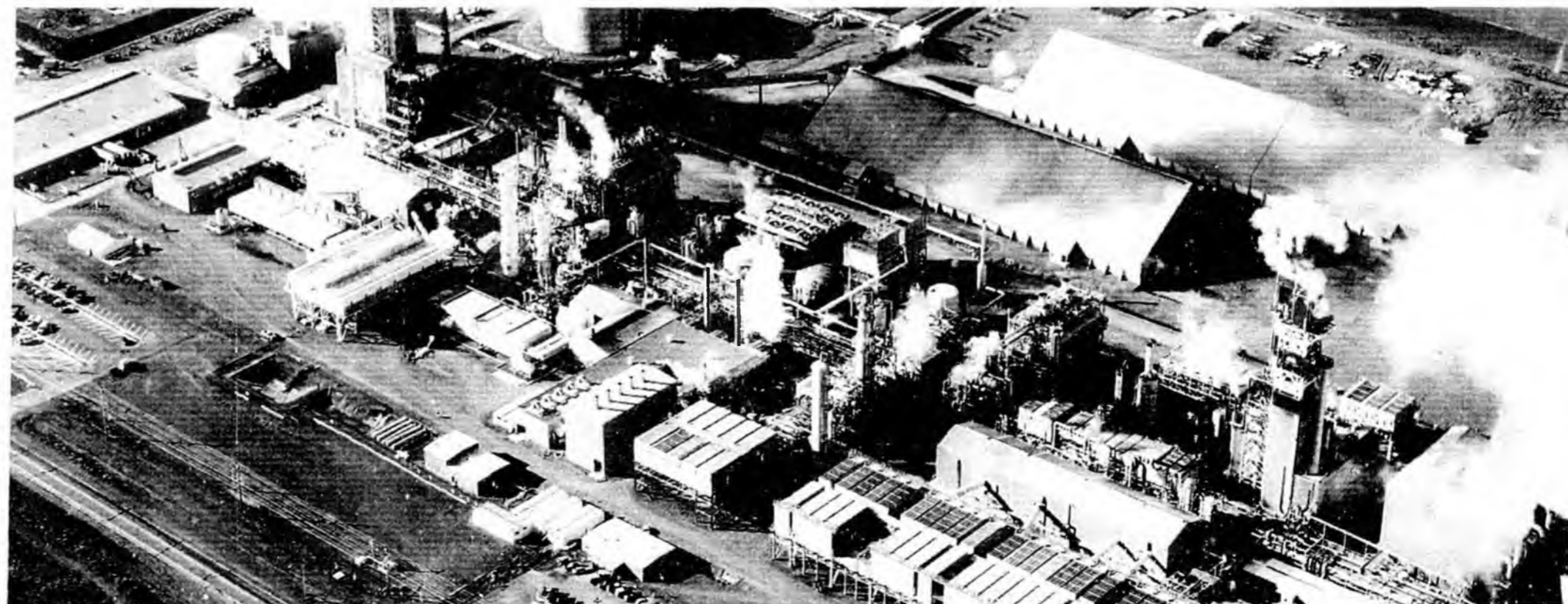
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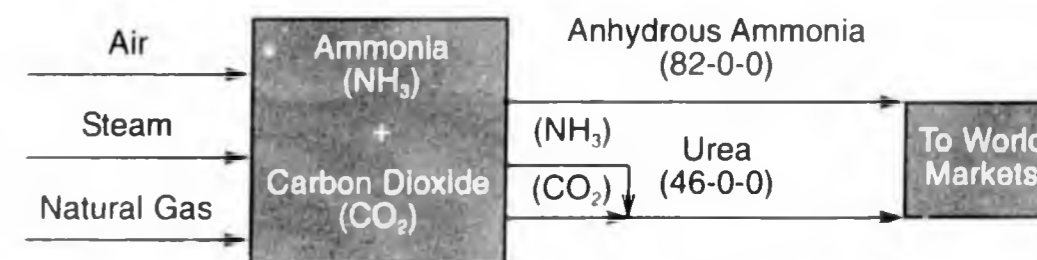
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kenai

nitrogen operations

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More than seven years in the fertilizer business have taught us how to compete and stay ahead of the competition.

Agrium

Kenai
Nitrogen Operations

P.O. Box 575,
Mile 21, Spur Highway
Kenai, Alaska
99611

Phone: (907) 776-8121

Fax: (907) 776-5579

<http://www.agrium.com>

***The Economic Impact of
Closing Agrium Kenai
Nitrogen Operations***

***PREPARED FOR:
Agrium U.S. Inc.***

PREPARED BY:



Anchorage • Juneau

April 2004

TABLE OF CONTENTS

Executive Summary	1
Summary of Role in the Economy	1
Economic Impacts of Agrium Closure	3
Scope of Work and Methodology	6
Scope of Work	6
Methodology	6
Overview of Agrium U.S. Activities	8
Background on Agrium Kenai Nitrogen Operations	8
Agrium Direct Economic Impacts	9
Direct Employment and Payroll	9
Taxes.....	11
Charitable Contributions and Membership Organizations	12
Summary of Direct Spending	13
Indirect and Induced Impacts	14
Indirect and Induced Output Impacts	15
Indirect and Induced Employment and Earning Impacts	15
Socioeconomic Impacts	15
Plant Closure Impacts	17
Case Studies	17
Kenai Peninsula Borough Impacts from Agrium Plant Closure	19
Statewide Impacts of Agrium Plant Closure	21

EXECUTIVE SUMMARY

Agrium U.S. Inc. contracted with McDowell Group, an Alaska research-based consulting firm, to quantify the economic impact of closing down Agrium Kenai Nitrogen Operations on the Kenai Peninsula Borough and the Alaska economy. This report details the study findings of the economic role of Agrium's production on the Kenai Peninsula and Alaska, and then assesses the impact if this production stopped and the plant closed.

Agrium Kenai Nitrogen Operations is one of Alaska's few major manufacturing operations and contributes significantly to Alaska's economy by adding value to Cook Inlet natural gas production. The Agrium complex is located near Nikiski on the Kenai Peninsula, 10 miles north of Kenai. In 2003, Agrium reported an average annual employment of 264. With a June 2003 downsizing, the plant's current employment is 230. The plant is the United States' second largest producer of ammonia and urea. It consists of two urea and two ammonia plants, a tidewater port facility, and a power cogeneration facility. In 2003, the Kenai plants produced 1.6 million metric tons of anhydrous ammonia and urea. The plant operated at 75 percent capacity, using approximately 110 million cubic feet of Cook Inlet natural gas daily (or 40 billion cubic feet annually). At capacity, the plant could use as much as 155 million cubic feet daily (or 53 billion cubic feet annually) of Cook Inlet natural gas. Virtually all of Agrium's Kenai production is destined for overseas markets. Agrium's total gross sales in 2003 were \$220 million.

Summary of Role in the Economy

Economic Output

- Total economic output in Alaska related to Agrium operations was \$374 million in 2003. Economic output is the gross sale of Agrium's production plus the impacts of company and employee spending in support of Agrium's operations.
- For every one thousand cubic feet (Mcf) of Cook Inlet natural gas used by Agrium for feedstock and power generation, over \$9 in total Alaska economic output is generated.
- In 2003, Agrium spent \$77 million on goods and services provided by almost 400 Alaska companies. Purchases were made from gas producers, construction contractors, engineering firms, environmental service firms, utility companies, retail and wholesale businesses, and other types of businesses.

Employment and Payroll

- Total Alaska impacts include 685 Alaska jobs (2003 average of 264 direct plus 421 indirect and induced jobs) and \$42 million in payroll (\$22 million in direct wages plus \$20 million in indirect and induced payroll).

- Agrium provides year-round, high-paying skilled manufacturing jobs.
- The Agrium operation also accounts - directly and indirectly - for an estimated 2 percent of the population, 4 percent of employment, and 7 percent of wage and salary income in the Kenai Peninsula Borough.
- Agrium's work force is virtually 100 percent resident in the Kenai Peninsula area. This fact, in turn, directs household spending locally, as opposed to other income sectors that have significant non-resident components. According to the Alaska Department of Labor and Workforce Development, in 2002, non-residents held 21 percent of the private sector jobs in the Kenai Peninsula Borough.

Community Involvement

- In 2003, Agrium contributed \$195,000 to 43 non-profit organizations or programs, most of them located in the Kenai area. Seven other organizations received in-kind support.
- Charitable giving was provided to local schools' athletic and academic programs, youth activities, community services and civic organizations, environmental programs, senior services, and other health and economic development programs.
- Agrium participated in 17 membership organizations, including industry and business support organizations.

Government Revenues

- The Kenai Peninsula Borough receives \$2 million in industrial property tax from Agrium, an estimated minimum of \$0.2 million in residential property tax from Agrium's employees' dwellings, and \$1 million in state funding support for Agrium family school-age children's education - a total of \$3 million in direct revenue.

Table 1
Summary of Statewide Agrium Kenai Nitrogen Operations
Economic Impacts, 2003

	Direct Impacts	Multiplier Effect	Indirect and Induced Impacts	Total Impacts
Economic Impacts				
Output	\$220 million	1.7	\$154 million	\$374 million
Economic value of Agrium production per MCF of natural gas feedstock				\$9.35/Mcf
Employment	264 jobs	2.6	421 jobs	685 jobs
Payroll	\$22 million	1.9	\$20 million	\$42 million
AK goods & services purchased	\$77 million			

(Table continues next page)

**Table 2
Summary of Agrium's Economic Impacts on the
Kenai Peninsula Borough, 2003**

	Direct Impacts	Multiplier Effect	Indirect and Induced Impacts	Total Impacts
Kenai Peninsula Borough Employment and Payroll				
KPB Employment	264 jobs	2.2	317 jobs	580 jobs
Employment (% of KPB 2002 total)				3%
Payroll	\$22 million	1.6	\$13 million	\$35 million
Wage and salary income (% of KPB 2002 total)				6%
Revenue to Kenai Peninsula Borough (KPB)				
Agrium industrial property tax	\$2.2 million			
Agrium employee property tax	\$0.2 million			
State revenue to KPB School District for Agrium dependents	\$1.1 million			
Total revenue to KPB	\$3.5 million			
Social Impacts				
Total population impacts (direct and indirect)				1,250 total 2.4% of KPB
Student enrollment (Agrium children as % of total KPB District enrollment)	2.5%			
Number of charities supported	50			

Economic Impacts of Agrium Closure

Alaska's Plant Closure Case Studies

Based on profiles of two Alaska communities - Ketchikan and Wrangell - that have lost important manufacturing facilities, a community in Alaska experiencing a similar loss can expect some or all of the following:

- Immediate loss of some of the community's highest paying, year-round jobs.
- Some immediate population loss, but also gradual, long-term population decline.
- Declining average wages as manufacturing jobs are not replaced in the local economy or are replaced by lower paying service sector jobs.
- Declining business sales and sales tax revenues.
- Declining property tax base that results in declining tax revenues.

- Increased tax burden on residents and businesses that remain and/or cuts in local government services.
- Economic consequences much greater than just the direct jobs lost with the closure if there is no growth elsewhere in the economy.

Kenai Peninsula Borough Impacts from Agrium's Closure

The Borough would experience both direct and indirect impacts on its economy. Based on current employment figures, estimates of direct impacts include:

- Immediate loss of 230 jobs and \$19 million in annual payroll.
- Borough-wide employment dropping by 1.3 percent and payroll by 3.2 percent.
- Average monthly wage for the Borough dropping by 1.9 percent.
- Immediate loss of \$2 million in property tax revenues, representing 5 percent of the Borough's total property tax revenues.
- 43 non-profit organizations losing \$195,000 in contributions, perhaps more when including contributions made directly by Agrium employees.
- Immediate loss of \$77 million in business sales.

Using multipliers for the Kenai Peninsula Borough (employment and payroll multipliers of 2.2 and 1.6 respectively), estimates of indirect impacts on the Borough include the potential loss of about 280 support sector jobs and \$11 million in annual support sector payroll.

Statewide Impacts from Agrium's Closure

Based on current employment figures (230 employees) and statewide multipliers, Agrium's closure could result in a loss of a total 600 jobs and \$36 million in payroll statewide. Agrium's closure could also affect the Alaska economy in the following ways:

- Natural gas production in Cook Inlet would be deferred by an estimated 40 billion cubic feet per year. This deferred production would result in immediate loss of state revenue from Cook Inlet gas royalty and severance taxes. It is estimated this loss of state revenue would be \$11.6 million.
- Alaska's exports would immediately drop by 7 percent, a value of \$200 million.
- Alaska's manufacturing base would suffer from a significant loss in high-paying, year-round, resident jobs. Loss of these jobs would continue a trend that has important long-term implications, including the out-migration of young people who cannot find viable employment.

- Finally, closure of the Agrium plant would represent a major step back in Alaska's effort to add value to its natural resources before shipping to outside markets. Economic development efforts in Alaska are all about adding value to resources, creating family-wage jobs for Alaskans, and providing a local tax base to support essential public services. Agrium brings all of these to Alaska.

SCOPE OF WORK AND METHODOLOGY

Scope of Work

The purpose of this study is to measure the economic role of Agrium's production of urea and anhydrous ammonia at its Kenai plant on the economies of the Kenai Peninsula Borough and Alaska in 2003 and the potential economic impact if production at the plant were to close. The study includes:

The Role in Alaska's Economy

- A brief overview of Agrium's activities in Alaska
- Agrium direct spending for goods and services in Alaska
- Borough government revenues from Agrium
- Direct employment and annual payroll
- Agrium's donations to charities and membership organizations
- Indirect and induced payroll and employment from Agrium direct spending.

Closure Impacts

- A brief overview of socioeconomic impacts on employment, government revenue, export markets, and other components of the economy.

Methodology

Several methodologies were used to produce this study, including primary research, secondary data collection, interviews with Agrium representatives and borough government officials, and use of predictive econometric models. The economic data was collected from several official sources.

Agrium Expenditures

In order to estimate Agrium spending, the study team utilized data on Alaska vendor spending by location and by industrial classification.

The vendor data was reviewed and aggregated into 10 sectors:

- Natural Resources (including natural gas production)
- Manufacturing
- Trade, Transportation and Utilities
- Information

- Financial Activities
- Professional and Business Services
- Educational and Health Services
- Leisure and Hospitality
- Construction
- Other Services
- Government

Donations to charitable causes and payments to membership organizations were provided by Agrium U.S.

Government Revenue

Agrium U.S. provided information concerning tax and fee revenue paid to the Borough government, and 2003 corporate tax filings and other fees to the state. The Kenai Peninsula Borough provided additional supporting data on property and sales taxes.

Employment and Payroll

Direct employment and aggregate payroll data were derived from official Alaska Department of Labor and Workforce Development reports that Agrium files with the state and data provided directly by Agrium. Use of the state database allows for direct comparisons to all other official employment and payroll data for the Kenai Peninsula Borough and for accurate econometric modeling results. Full-time, part-time, and seasonal employment is accounted for in this database.

Indirect and Induced Economic Impacts

The study team used the IMPLAN econometric models for the nitrogenous and phosphatic fertilizer manufacture sector in the Kenai Peninsula Borough to estimate indirect impacts from Agrium output at the Borough and statewide level. To verify the relevancy of the IMPLAN model, the study team used the known direct expenditures provided by Agrium to evaluate the relationships between Agrium-related activities and other businesses in Kenai Peninsula Borough. The direct, indirect, and induced impacts on output, employment, and payroll were aggregated to obtain total impact. Dividing total impact by direct impact produces a multiplier.

OVERVIEW OF AGRIMUM U.S. ACTIVITIES

Background on Agrium Kenai Nitrogen Operations

Agrium contributes to Alaska's economy by adding value to Cook Inlet natural gas production. In September 2000, Unocal completed the sale of its agricultural products business, including its subsidiary, Alaska Nitrogen Products LLC (ANP) to Calgary-based Agrium Inc. Unocal's Alaska oil and gas business unit continues to supply natural gas to Agrium from Cook Inlet fields and onshore production facilities as part of a 1998 agreement. The agreement expires in 2009. The Agrium Kenai Nitrogen Operations complex is located near Nikiski, 10 miles north of Kenai. When it was built in 1968, it consisted of one urea and one ammonia plant. Production started in 1969. In 1977, the complex doubled in size, adding another urea and ammonia plant with supporting utilities.

Currently, the Kenai plant is the United States' second largest producer of ammonia and urea (after CF Industries' Louisiana operations). The Agrium Kenai Nitrogen Operations complex has an annual production capacity of nearly 2 million metric tons. In 2003, the Kenai plants produced 1.6 metric tons of anhydrous ammonia and urea. For feedstock, the plant uses approximately 110 million cubic feet of natural gas daily. In 2003, Agrium's sales totaled \$220 million.

Virtually all of Agrium's Kenai production is destined for overseas markets, including South Korea, Mexico, Taiwan, Thailand, Australia, Chile, New Zealand, and the Philippines. Within Alaska, product is distributed and sold in small quantities. In 2003, Agrium's exports represented 7.3 percent of all Alaska exports for all products.

AGRIUM DIRECT ECONOMIC IMPACTS

Agrium spent \$101 million in Alaska in 2003. Direct impacts include the money actually spent by Agrium in its normal business activity for payroll for Agrium's direct employees, goods and services, government taxes and fees, and charitable contributions. The components of these four types of direct spending, including direct employment, are described in the following sections.

Direct Employment and Payroll

All of Agrium's Alaska employees live on the Kenai Peninsula. In 2003, Agrium employed an annual average of 264 workers in the Kenai Peninsula, earning an annual \$21.8 million in wages. When adding employee benefits, total payroll and benefits expenditures are \$29.5 million. While it is beyond the scope of this study to capture the economic impacts of employee benefits, it is assumed that some portion of the \$7.6 million Agrium spends on employee benefits remains in Alaska. For example, Agrium's employee benefit expenditures circulate in the Alaska economy when employees' health care and retirement payments are made locally to those retirees remaining in the area.

According to the Alaska Department of Labor and Workforce Development, in 2002, Agrium was the third largest private employer in the Kenai Peninsula Borough. Peak Oilfield Service Company is the largest private employer. Safeway/Eagle Stores' employment was the second highest employer, but their payroll would be substantially smaller than Agrium's payroll (payroll data by individual company is not publicly available). When public employers are included, Agrium Kenai Nitrogen Operations was the seventh largest employer.

With the June 2003 restructure of Agrium and the loss of positions, it is expected that Alaska Department of Labor and Workforce Development 2003 data may show that Agrium has fallen to fourth or fifth largest private employer in the Kenai Peninsula Borough.

Table 3
The Top 10 Private Employers in the Kenai Peninsula Borough, 2002

Company	Annual Average Employment
Peak Oilfield Services Company	349
Safeway/Eagle Stores	331
Agrium Kenai Nitrogen Operations	297
Frontier Community Services	278
Fred Meyer	225
Alaska Petroleum Contractors	209
Union Oil of California	177
Tesoro Alaskan Petroleum Company	176
Veco Alaska	161
South Peninsula Behavior Health Services Inc.	143

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

In 2002, Alaska Department of Labor and Workforce Development data shows that Agrium's employment peaked in March and April (302 and 301 positions, respectively). 2003 data shows the drop from June employment of 283 to July's employment of 241 positions, resulting from the restructure. Full-year data for 2003 was not available at the time this study was produced.

Approximately two-thirds of Agrium employees are assigned to maintenance and operations, while the remaining third are technical, supervisory, and management staff. Maintenance employees include: millwrights and machinists, welders and pipe fitters, general craftsman, instrument and electrical technicians, and warehouse supply workers.

As shown in the table below, Agrium employees are among the highest paid workers in the Kenai Peninsula, making two and half times higher the average wage paid in the Borough.

Table 4
Agrium Kenai Nitrogen Operations, 2003 and Kenai Peninsula Borough
Annual Average Monthly Employment and Earnings, by Industry, 2002

Industry	Annual Average Monthly Employment	Average Monthly Earnings*	Average Annual Earnings*
Agrium Kenai Nitrogen Operations	264	\$6,882	\$82,582
Natural resource and mining	1149	5,717	68,604
Oil and gas extraction	239	9,943	119,316
Construction	1,200	3,395	40,740
Manufacturing	1077	4,080	48,960
Trade, transportation and utilities	3,579	2,463	29,556
Information	262	3,071	36,852
Financial activities	445	2,351	28,212
Professional and business services	830	2,141	25,692
Health and education services	1,346	1,959	23,508
Leisure and hospitality	2,191	1,175	14,100
Other services	772	1,316	15,792
Federal government	428	4,273	51,276
State government	1,085	3,113	37,356
Local government	3,025	2,988	35,856
All industries average	17,628*	\$2,798	\$33,576

*Subtotals do not add up to total because not all subtotals for every industry categories available are presented.
Source: Agrium Kenai Nitrogen Operations. Alaska Department of Labor and Workforce Development

In the process of manufacturing urea and ammonia, Agrium spent approximately \$77.1 million on Alaska goods and services during 2003.

This spending was distributed among 384 Alaska businesses from nearly all sectors of the economy. Eighty-four percent of the Alaska vendor spending occurred in the Kenai Peninsula Borough. The single largest category (\$60.9 million) was purchases of natural gas used in feedstock and power generation. Purchases of trade, transportation and utilities (new construction and maintenance) represent a distant second largest expenditure category (\$6.6 million). Third in line are purchases for construction and oilfield services (\$6.0 million). The table below provides total direct purchases of Alaska goods and services by expenditure category.

Table 5
Agrium Expenditures on Goods and Services in Alaska,
by Expenditure Category, 2003

Category	Spending (\$)
Natural Gas	\$60,930,559
Trade, transportation and utilities	6,627,139
Construction	6,015,497
Other natural resources	1,720,003
Professional and business services	1,133,596
Manufacturing	454,401
Information	158,582
Educational and health services	31,499
Leisure and hospitality	30,738
Financial activities	18,530
Total Local Purchases of Goods and Services	\$77,120,545

Figures do not include charitable spending, membership organizations or payment to governments.
Source: Agrium Kenai Nitrogen Operations. McDowell Group compilations

Taxes

Agrium pays taxes and fees directly to the Kenai Peninsula Borough. Local borough taxes paid by Agrium include property tax for facilities owned and operated by Agrium to manufacture urea and ammonia; that is, their production facilities and transportation facilities. The total tax revenues paid to the Kenai Peninsula Borough in 2003 based on the assessed value of Agrium's plant and equipment was \$2.2 million, representing 5 percent of Kenai Peninsula Borough's total property tax receipts (\$41.7 million).

Agrium also paid \$221,000 in 2003 estimated corporation tax payments and \$111,800 for other services to the State of Alaska.¹

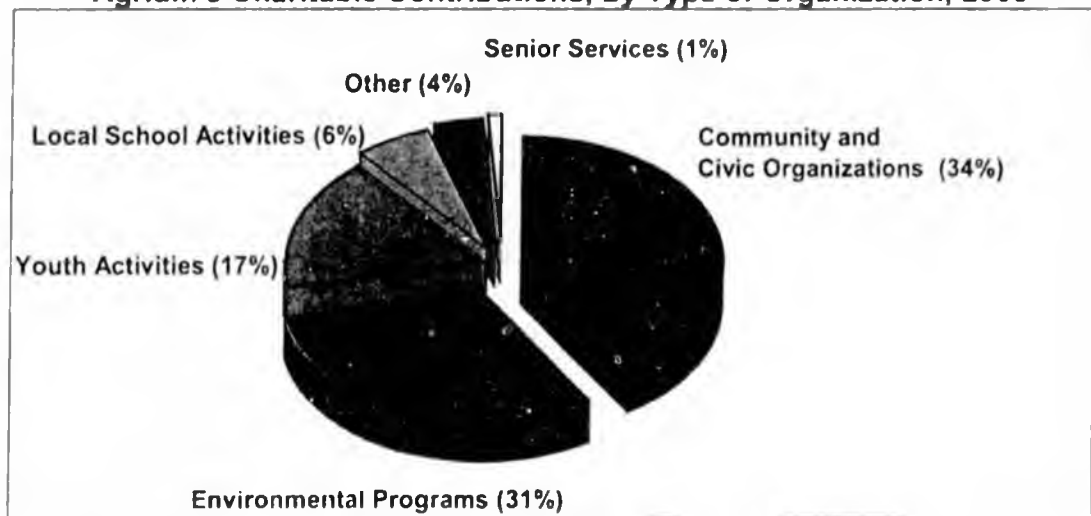
¹ Final corporation tax figure to be finalized in the summer of 2004.

Charitable Contributions and Membership Organizations

Agrium had an additional impact of \$194,740 on the local and Alaska economies through its charitable donations paid to local organizations. In 2003, Agrium made cash contributions to 43 non-profit charitable organizations in Nikiski, Kenai, Soldotna, Sterling, and Anchorage. Agrium also provided in-kind support to seven organizations on the Kenai Peninsula.

These non-profit organizations ranged from local school programs (in 22 different sports and academic activities), youth athletic and academic programs (17 activities), community services and civic organizations (16), environmental programs (1), senior services (2), and a variety of other health, sport, and economic development programs (9).

Figure 1
Agrium's Charitable Contributions, by Type of Organization, 2003



Source: Agrium Kenai Nitrogen Operations

Agrium Kenai Nitrogen Operations matched dollar-to-dollar its employees' contributions to the United Way of Kenai. In 2003, the total contribution to United Way, including employee contributions, was \$59,700. Agrium is also a co-sponsor of the *Caring for the Kenai* program. This program challenges high schools students to create, invent, or improve ways to better care for the Kenai Peninsula's environment.

While it is unclear how these charitable donations are distributed within the state, it is likely that a significant portion remains in the Kenai Peninsula. In-kind donations made by Agrium and its employees were not captured in this study, but it is known that some employees are actively giving back to their community, through volunteering and provision of skills, equipment, and material.

Agrium supported 17 membership organizations located in Kenai, Soldotna, North Pole, and Anchorage by giving \$20,100 in membership support.

As Agrium-related spending circulates through the economy, it creates additional jobs and income for Kenai Peninsula and Alaska residents. These indirect output, employment, and earnings impacts are discussed in the following section.

Summary of Direct Spending

Agrium's total 2003 direct spending in Alaska was \$101 million. This amount was used to pay its employee's payroll, local property taxes, purchases of Alaska goods and services, and charitable contributions.

Table 6
Summary of Direct Spending in Alaska by Agrium, 2003

Category	Value
Total employee payroll	\$22 million
Total Agrium payments to Kenai Peninsula Borough	\$2.2 million
Purchases of goods and services	\$77 million
Charitable giving	\$195,000
Total Direct Spending	\$101 million

INDIRECT AND INDUCED IMPACTS

In addition to the \$220 million in gross sales of Agrium's 2003 production, an average of 264 jobs and \$21.8 million in total annual payroll resulting from direct employment, Agrium Kenai Nitrogen Operations also indirectly creates sales, jobs and earnings through the Kenai Peninsula and Alaska support sectors. This activity is often referred to as a "ripple effect" or a "multiplier impact."

Using the example of employment impacts, additional jobs are created in two ways. First, local spending by Agrium on services and supplies creates jobs in the businesses providing those services and supplies. These jobs are termed "indirect" jobs. Second, spending by Agrium employees in local stores and with local service providers (i.e., banks, doctors, auto repair shops, etc.) also creates jobs. These are termed "induced" jobs. Commonly, indirect and induced impacts are lumped together under the label of indirect employment.

Indirect employment (including induced) can be estimated using multipliers. By applying a multiplier to known direct employment, total employment (direct plus indirect) can be calculated. In Alaska, multipliers are typically between 1.5 and 2.5, meaning that the total (direct and indirect) employment impact of a business that employs 100 workers is between 150 and 250 jobs. In other words, for every direct job, one-half to 1.5 additional jobs are created in the support sector. Payroll impacts are estimated in the same way.

As Agrium spends money locally on goods and services, new earnings are created. Multipliers reflect the fact that money circulates through an economy at different rates depending upon the type of business at which money is spent and the economy in question. The magnitude of the output, employment, and earnings multipliers depends on, first, how much money the employer spends locally on goods and services, the average salary of employees, and the residency of those employees. Because Agrium spends over \$85 million in the Alaska economy and supports high-paying jobs located in the Kenai Peninsula, the multiplier impact of Agrium is higher than the multiplier for most of Alaska's industries, with the notable exception of oil and gas production.

Calculating multipliers that apply specifically to Agrium Kenai Nitrogen Operations would require complex econometric modeling of the Kenai Peninsula Borough that is far beyond the scope of this study. However, using IMPLAN, a predictive model of local and state economies, it is possible to calculate reasonable estimates of multiplier impacts.

For the Kenai Peninsula Borough, IMPLAN produces multipliers for more than 500 industrial categories. For the nitrogenous fertilizer manufacturing sector in the Kenai Peninsula Borough, IMPLAN reports an output multiplier of 1.5, and employment and earnings multipliers of 2.2 and 1.6, respectively. Statewide multipliers are 1.7 for output, 2.6 for employment, and 1.9 for earnings.

Indirect and Induced Output Impacts

In 2003, Agrium's gross sales were \$220 million. The gross sales of Agrium's production plus the indirect and induced impacts of spending in support of Agrium's operations – an additional \$154 million – results in a total estimated statewide economic output of \$374 million.

In 2003, Agrium purchased 40 billion cubic feet of Cook Inlet natural gas. For every thousand cubic feet (Mcf) of Cook Inlet natural gas used by Agrium for feedstock and power generation, \$9.35 in total economic output is generated.

Indirect and Induced Employment and Earning Impacts

Applying a statewide employment multiplier of 2.6 and an earnings multiplier of 1.9 to Agrium's 264 direct jobs and \$22 million in annual payroll, Agrium's total employment and payroll impact on the Alaska economy is estimated at 685 direct, indirect and induced jobs and \$42 million in direct, indirect, and induced payroll (including 421 indirect and induced jobs, and \$20 million indirect and induced payroll).

In the Kenai Peninsula Borough alone, Agrium creates a total of 580 jobs and \$35 million in annual payroll, based on the multipliers described above. When factoring in the total direct, indirect, and induced employment and payroll impacts, Agrium's total payroll supports 5.9 percent of total Kenai Peninsula Borough payroll, and 3.2 percent of total Kenai Peninsula Borough employment.

Socioeconomic Impacts

Population

Based on the relationship between the employment and population on the Kenai Peninsula Borough, the 580 Agrium-related jobs support a population of 1,250.² This population impact accounts for 2.4 percent of the Kenai Peninsula Borough's total population (51,187).

Student Enrollment and Kenai Peninsula Borough School District Revenue

Agrium employees have 244 school-age dependents (between the years of 5 and 18). Assuming most of these dependents are enrolled in public schools in the Kenai Peninsula, Agrium's families accounted for 2.5 percent of Kenai Peninsula Borough School District school enrollment (9,697) in the 2002/2003 school year.

² 580 total jobs divided by the labor participation rate for Kenai Peninsula Borough (46.5 percent).

According to the School District, the State of Alaska provided \$44.1 million to the District in FY03. On average, the District received \$4,549 per student from the State of Alaska. Thus, Agrium school-age dependents accounted for \$1.1 million in state revenue to the Kenai Peninsula Borough School District. When including Borough revenue (\$30.7 million), federal revenue (\$0.2 million), and other revenue (\$0.1 million), the average per student contribution is \$7,827. Therefore, Agrium school-age dependents could account for up to \$1.9 million in Kenai Peninsula Borough School District General Fund revenue.

Property Tax Revenue

Property tax on employees' homes is not specifically calculated in this study. Several methods for evaluating property tax impacts were considered. Without specific data on number of homes owned or rented by Agrium employees, the study team used a more general measure. Using average taxable value for single-family units (\$115,153) at the Borough mill rate of 6.5, and assuming that all Agrium employees own their own home, Agrium families pay at least \$200,000 in Borough property taxes exclusive of additional service area and city taxes on residential property. Because of the high average wage for Agrium employees and the propensity of higher income earners to own higher valued homes, the actual figure, if known, could be significantly higher. In addition, this figure does not include property tax contributions by the population of homeowners affected indirectly by Agrium's activity.

Sales Tax Revenue

It is not possible to precisely calculate the Borough's sales tax collection that is due to all of Agrium's economic impacts on the Peninsula. Borough sales tax collections result from a complex system of variable taxation depending on specific location of the expenditure, per invoice limit of \$500 regardless of the total value of the product purchased, expenditures by both residents and non-residents, and expenditures by Peninsula businesses and industries that are not exempt from sales taxation due to the resale provision of the sales tax code.

However, given that Agrium's total impacts account for 3 percent of total Borough employment, 6 percent of total Borough payroll and 2 percent of the Borough's population, it can be assumed that there are significant direct and indirect sales tax revenue impacts from Agrium's spending.

PLANT CLOSURE IMPACTS

This section addresses the potential economic impacts of closure of the Agrium plant. The preceding chapters identified what is at stake - hundreds of jobs and millions of dollars in direct and indirect payroll, and property tax revenues. This chapter describes how the loss of the Agrium facility would ripple through the Kenai Peninsula Borough economy both in the near-term and over the long-term. It also considers the economic impact of plant closure throughout the state

The discussion begins with two case studies - profiles of communities elsewhere in Alaska that have experienced the closure of large manufacturing facilities. The case study discussion is followed by an analysis of the likely impacts in the Kenai Peninsula Borough, and elsewhere in the state, from Agrium plant closure.

Case Studies

Ketchikan

In 1996, Ketchikan Pulp Company was Ketchikan's single largest employer, with 450 employees earning \$20 million in annual payroll. The mill closed in 1997, and the community entered a period of economic decline that continues today. Since the mill closed, Ketchikan's population has declined by 1,200 residents, approximately 8 percent of the community's total population. Six years after mill closure, Ketchikan's population decline continues. Between 2002 and 2003, Ketchikan lost another 150 residents.

Employment in Ketchikan in 2003 was approximately 1,000 jobs below the pre-mill closure level. The average inflation-adjusted monthly wage in Ketchikan fell from \$3,050 in 1996 to \$2,680 in 2002 (the latest available data). Real (inflation adjusted) payroll fell from \$290 million in 1996 to approximately \$215 million in 2002, a loss of 25 percent.

Gross sales have fallen from \$525 million to \$400 million annually, a decline of nearly 25 percent.

While Ketchikan continues to suffer significant economic fall-out from mill closure, growth in other sectors of the economy has prevented even greater decline. For example, cruise ship passenger traffic to Ketchikan increased from 500,000 passengers in 1997 to over 700,000 passengers in 2003. These 200,000 additional passengers spent \$20 million in Ketchikan in 2003, providing important business sales and sales tax revenues for the community. Without this offsetting economic activity, the impact of mill closure would have been much more severe.

Other effects of mill closure in Ketchikan include declining sales and property tax revenues, declining school enrollment, increased seasonality in the local economy, and other effects.

What is noteworthy is the timing of the economic losses in Ketchikan. It has been six years since the mill closed, yet the economy continues to struggle. Further, the community has still not found the bottom of an economic downturn brought on by mill closure.

Wrangell

Until 1994, the Alaska Pulp Corporation's sawmill was Wrangell's single largest employer. The mill employed 200 workers, one-fifth of the community's wage and salary employment. Mill closure in 1994 precipitated a steady and dramatic decline in the local economy. Wrangell's population in 1994 stood at 2,754 residents. In 2005, after nine years of almost continuous decline, Wrangell's population totaled 2,113 residents. Since the mill closed the community has lost over 600 residents - 23 percent of Wrangell's population. Following are several other indicators of Wrangell's economic condition, following mill closure:

- Wage and salary employment remains 17 percent below the pre-mill closure level. The most recent data shows continuing annual decline.
- Total annual payroll remains \$7 million below the pre-mill closure level, a loss of 20 percent, with continuing annual decline.
- School enrollment declined from 555 students in 1995 to approximately 400 students in the 2003-04 school year.
- Wrangell's average wage, in inflation-adjusted dollars, is 20 percent below the pre-mill closure level. The average monthly wage is \$600, in terms of real purchasing power, below the 1994 level.

In summary, Wrangell's economy has yet to recover from an economic shock that occurred a decade ago. Unlike Ketchikan, Wrangell has very little economic activity to offset the continuing decline stemming from mill closure.

Case Study Summary

These case studies illustrate how plant closures can impact local economies. To summarize, a community that experiences the loss of an important manufacturing facility can expect some or all of the following:

- Immediate loss of some of the community's highest paid jobs - and year-round jobs
- Some immediate population loss, but also gradual, long-term population decline
- Declining average wages as plant jobs are not replaced in the local economy or are replaced by lower-paying service sector jobs
- Declining business sales and sales tax revenues

- Declining property tax base (manufacturing facilities typically require high levels of investment in taxable plant and equipment) which results in declining tax revenues
- Increased tax burden on residents and businesses that remain and/or cuts in local government services.

In the absence of growth elsewhere in the economy to offset the affects of plant closure, the economic consequences can be much greater than the loss of jobs at the plant.

Kenai Peninsula Borough Impacts from Agrium Plant Closure

Direct Borough Impacts

In June 2003, the Borough lost 65 jobs and nearly \$5 million in annual payroll as a result of Agrium restructuring its operations. With the full closure of the Agrium plant, the Borough would immediately lose 230 jobs and \$19 million in annual payroll. Borough-wide employment would drop by 1.3 percent and payroll by 3.2 percent.

With the loss of 230 jobs averaging over \$80,000 in annual payroll, the Borough economy will lose some of its highest paying jobs. Plant closure will result in a decline of 1.9 percent in the Borough's average monthly wage.

The Kenai Peninsula Borough would immediately lose \$2 million in property tax revenues. The assessed value of Agrium's assets includes approximately \$1.4 million for the 225 acres the plant sits on and \$170 million for the plant itself. While the land may retain most of its assessed value, the plant will be worth no more than its salvage value, which would likely be less than 10 percent of its operational value. The loss of \$2 million in property tax revenues would represent approximately 5 percent of the Borough's total property tax revenues. Either the Borough would be forced to make significant cuts in services or other property owners would make up for the Agrium-related loss through higher tax payments.

With closure of the Agrium plant, 43 non-profit organizations would lose a combined total of \$195,000 in contributions. These and other non-profits may also lose contributions made directly by Agrium employees.

Direct impacts associated with plant closure would also include lost sales for businesses that provide goods and services to Agrium. In 2003, Agrium purchased \$77 million in goods and services from 384 Alaska businesses. A majority of this spending was on natural gas purchases (the impact of the loss of Agrium as a gas market is described below).

Indirect Borough Impacts

Support sector employment: Indirect impacts of plant closure could include loss of jobs in the support sector. The likelihood, timing and magnitude of these potential losses would depend on a variety of factors. The condition of the Borough economy overall is one critical factor. If the area economy is weak, the employment losses associated with plant closure could include all of the indirect and induced employment linked with Agrium. As described earlier, using employment and payroll multipliers for the Kenai Peninsula Borough, Agrium accounts for an estimated 510 jobs in the Borough economy. This figure includes direct (230 jobs), and indirect and induced employment. It would also account for \$30 million in total payroll. This figure includes direct (\$19 million), and indirect and induced payroll. That means that about 280 support sector jobs are at stake, along with \$11 million in annual support sector payroll. These are jobs in stores, schools, doctor's offices, construction companies - jobs throughout the economy.

On the other hand, if other sectors of the economy are growing and generating additional business and personal income, employment losses in the support sector might not materialize.

According to Alaska Department of Labor data, employment in the Borough's economy has been growing slowly, at a rate of approximately 1.5 percent annually over the past five years. This slow growth trend, if it were to continue, would suggest that the Kenai Peninsula Borough might avoid the worst-case scenario associated with Agrium plant closure.

While growth elsewhere in the economy might prevent layoffs of workers in the support sector, it is nevertheless true that the economy would experience a significant opportunity cost. Suppose, for example, five years after plant closure, total borough employment is about 250 jobs below its current level. This would suggest that the economy would suffer the loss of direct Agrium jobs, but would be able to absorb the potential indirect Agrium-related losses through growth elsewhere in the economy. However, if Agrium's plant had not closed, the Borough economy would have 560 jobs more jobs than it would without Agrium. This is an important opportunity cost for the Kenai Peninsula Borough.

Housing and real estate markets: Closure of the plant and layoffs of 230 workers would result in some weakening of the local housing market. The impact on the housing market would depend on many factors, including the number of homes that would ultimately be placed on the market, interest rates (low mortgage interest rates would support home sales), and trends in sectors of the economy unrelated to Agrium. Job growth elsewhere in the economy would offset impacts on housing and real estate.

Borough taxes: As the housing and real estate market shifts in the Borough, it may also experience a loss in its residential property tax base. With a loss in payroll and spending within the Borough, it can be expected that sales tax receipts would also decrease.

Statewide Impacts of Agrium Plant Closure

Employment: Closure of the Agrium plant would have a range of statewide impacts. In terms of employment (and using statewide multipliers), at risk are the 600 jobs and \$36 million in payroll dollars that are directly or indirectly linked to Agrium operations in Alaska. As described above, while the state's economy may not experience a drop in employment of 600 jobs if the Agrium plant closes, over the long-term the state's economy without Agrium would be 600 jobs smaller.

Impacts on Cook Inlet Gas Production and Markets: Overall, Cook Inlet gas production is declining. Today's production is approximately two-thirds the 300 Bcf highs of the 1980s and early 1990s. Without exploration and development of significant new fields in Cook Inlet, the Alaska Department of Natural Resources forecasts gas production to decline to just 22.5 Bcf by 2022.³

Marathon and Unocal are the major players in the Cook Inlet oil and gas fields. These two companies were the operators for 29 of the 42 fields and pools in 2002. Other companies operating in Cook Inlet include Forest Oil Company, Aurora Gas, LLC, Conoco/Phillips, and XTO Energy.

As part of its agreement when it sold its plant to Agrium, Unocal supplies Agrium with most of its natural gas feed stock.⁴ Unocal also supplies gas to Enstar, a gas utility company, through a long-term service contract.

As the primary supplier to Agrium, Unocal would be the player most greatly affected by Agrium's closure. If Agrium were to close, Unocal's gas production would be affected. The full extent of those effects is unknown. However, if there were no immediate demand for the newly available supply, Unocal would defer its production of this gas. This would lead to deferred state royalties and production taxes (see below).

The utility markets made up largely by Enstar, Municipal Light and Power, and Chugach Electric are holding stable and currently served by long-term contracts held with Cook Inlet gas producers. It is not expected that these long-term contracts will be affected by Agrium's closure.

Currently there is no industrial market outlet for Agrium's gas supply from Unocal. The Kenai LNG plant is producing at capacity served by Marathon and ConocoPhillips production.

State revenues: Of particular importance is the impact of plant closure on State of Alaska gas production royalties and severance taxes associated with gas production for Agrium's feedstock. Determining the precise royalty and severance tax value of Agrium's gas would require a complex analysis beyond the scope of this study. It is known that Cook Inlet gas production will generate approximately \$51 million in royalties and severance tax revenues to the State in 2004.

³ Alaska Department of Natural Resources, Division of Oil and Gas, *Alaska Oil and Gas Annual Report December 2003*, for historical years 1960 through 1987 and forecast years 2004 through 2022.

⁴ Unocal Corporation - 2002 Annual Report on Form 10-K - <http://www.unocal.com/annualreport/02-10-k.htm>.

Using 2003 gas volumes purchased by Agrium (40 bcf) as a base and given that there is no other existing market for this volume of gas, the state would lose as much as \$11.6 million in future annual state revenues from royalties and severance taxes (at a time when the State is struggling to balance its budget).⁵

In the long term, assuming Unocal deferred its production with the intention of selling this supply to another buyer at a higher price than what Agrium currently pays, the revenues to the state may be the same (in terms of present value) than what it currently receives. This, however, does nothing to mitigate the immediate loss to the state treasury.

In addition to gas royalty and production taxes, the state would also lose any future corporate tax revenue collected from Agrium.

Alaska exports: With the closure of the Agrium plant, total Alaska exports would decline by approximately 7 percent. The total value of Alaska exports of all products in 2003 was approximately \$2.7 billion. That year fertilizer exports were valued at \$200 million, representing 7.3 percent of total Alaska exports.

Economic development and adding value to Alaska's natural resources: Finally, closure of the Agrium plant would represent a major step back in Alaska's effort to add value to its natural resources before shipping to outside markets. Economic development efforts in Alaska are focusing on adding value to resources, creating family-wage jobs for Alaskans, and providing a local tax base to support essential public services. Agrium brings all of these to Alaska.

⁵ Estimate was provided by Agrium. Assumptions include: royalties based on Unocal's reported actual royalties paid from July 2002 to June 30, 2003, Beluga royalty rate of 7 percent based on DNR data, Beluga royalty price of \$1.20/mcf based on GSA pricing, price and royalty rate of "other gas" assumed to be the same as Unocal's gas, severance rate of 5 percent based on estimates of daily production rates per well and severance tax price based on GSA pricing.

Agrium

NEWS RELEASE & Q4 INTERIM REPORT

Agrium sets new fourth quarter earnings record

05-005

Date: February 10, 2005

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ALL AMOUNTS ARE STATED IN U.S.\$

CALGARY, Alberta -- Agrium Inc. (TSX and NYSE: AGU) announced today that net earnings for the fourth quarter were \$102-million (\$0.71 diluted earnings per share). Net earnings for the year were \$276-million (\$1.91 diluted earnings per share).

"We delivered strong results in 2004. EBITDA was over \$600-million; our cash position doubled from the previous year; and our revenues exceeded \$3-billion. Our Retail operations achieved record EBIT and EBITDA in 2004, with revenues reaching a record \$1.1-billion. Fourth quarter 2004 margins for all of our wholesale product groups increased both over the previous quarter and on a year-over-year basis," said Mike Wilson, Agrium's President and CEO.

"Our U.S. retail business is anticipating a good spring season based on feedback from customers. The fundamentals continue to be favorable for both our wholesale and retail operations, and we are looking forward to strong financial performance in 2005."

"We recently announced we are redeeming \$175-million in preferred securities with cash. This provides a number of financial benefits, such as reduced security charges and reduced dilution in our earnings per share, while maintaining our financial capability to pursue opportunities that add value for shareholders," said Mr. Wilson.

KEY DEVELOPMENTS

Pricing and gross margin improved in the fourth quarter of 2004 for all three major product groups both year-over-year and as compared to the third quarter of 2004. Strong urea and other nitrogen sales more than offset a weak fall ammonia application season in North America due to weather. Average nitrogen margins reached \$82 per tonne, representing an eight percent increase compared to the third quarter and a 28 percent increase over the same quarter last year. These higher margins were realized in spite of our effective gas cost increasing by \$1.23 /MMBtu from the fourth quarter of 2003 to \$4.54 /MMBtu for fourth quarter 2004 production. The AECO basis averaged \$1.06 /MMBtu for the fourth quarter and \$0.86 /MMBtu for the year. Agrium's average potash price continued to strengthen, increasing eight dollars per tonne over the third quarter, and Agrium's fourth quarter average phosphate margins increased by seven dollars per tonne over the previous quarter.

- Our Retail results were excellent, with total Retail EBITDA of \$21-million for the quarter and \$99-million for the year. Our U.S.-based retail operations delivered an eighth consecutive year of record earnings and our South American-based operations contributed \$11-million in EBITDA for the year. In February, Agrium announced the acquisition of additional retail operations in Argentina, Chile and Bolivia.
- Cash provided by operating activities was \$191-million in the fourth quarter, bringing the total cash provided by operating activities to \$449-million for 2004. In January, we announced the redemption of our eight percent preferred securities. In 2004, these preferred securities diluted our earnings per share by \$0.11.
- Moody's rating agency announced this week they have affirmed the senior unsecured debt rating of Baa2 for Agrium, and raised their outlook from negative to stable due to improved financial conditions and a solid industry outlook.
- In February, we announced plans to complete the engineering work to expand our production capability for our patented-process controlled release urea products. One of these products, ESN[®], recently received two separate awards, one in Canada and one in the U.S., for best new farm technologies.

Excluding Special Items, consisting of the Kenai-related award and settlement in 2004 and the write-down of our Kenai facility in 2003, net earnings for the fourth quarter of 2004 set a new record at \$75-million (\$0.52 diluted earnings per share), more than double net earnings of \$31-million (\$0.22 diluted earnings per share) for the same period in 2003. Excluding Special Items, net earnings for the year 2004 were \$224-million (\$1.56 diluted earnings per share), a significant improvement over 2003 net earnings of \$119-million (\$0.82 diluted earnings per share).

MANAGEMENT'S DISCUSSION AND ANALYSIS

February 9, 2005

The following Management's Discussion and Analysis (MD&A) contained in this interim report updates our annual MD&A included in our 2003 Annual Report to Shareholders, to which readers are referred. No update is provided where an item is not material or there has been no material change from the discussion in our annual MD&A.

OVERVIEW OF CONSOLIDATED FINANCIAL HIGHLIGHTS

Net Earnings

Agrium's fourth quarter consolidated net earnings were \$102-million, up \$211-million from the \$109-million net loss reported for the same quarter of 2003. Diluted earnings per share were \$0.71 compared to a loss of \$0.89 for the same quarter last year. While earnings continue to benefit from the tight supply and demand fertilizer market fundamentals, our fourth quarter results were improved by the recognition of liquidated damages in the quarter under the Arbitration Panel award and a \$36-million gain recognized from the settlement of litigation, both related to our Kenai, Alaska nitrogen facility.

The Kenai litigation settlement resolved our long-standing dispute with Union Oil Company of California (Unocal) over obligations under the Purchase and Sales Agreement, associated Earn-out obligations and gas supply issues. The settlement agreement establishes a definitive gas supply obligation from Unocal to the Kenai facility up until October 31, 2005. Agrium intends to close the Kenai facility in November of 2005 unless alternate economic gas supplies can be obtained.

For the year, consolidated net earnings were \$276-million, or \$1.91 diluted earnings per share. This is a \$297-million improvement over the prior year consolidated net loss of \$21-million or \$0.25 diluted loss per share. The 2003 year included a \$140-million after-tax asset impairment on our Kenai operations, while the 2004 results included \$86-million (\$52-million after-tax) Kenai award and settlement. Excluding all Kenai related items in both years, net earnings would have been \$224-million, or \$1.56 diluted earnings per share in 2004 compared to \$119-million, or \$0.82 diluted earnings per share in 2003.

The growth in both quarterly and full year net earnings is largely attributed to Wholesale operations in both North and South America, which have benefited from the tight supply and demand fertilizer market fundamentals.

Cash Provided by Operating Activities

Operating activities provided cash of \$191-million in the fourth quarter of 2004 compared \$70-million for the same quarter of 2003. The increase of \$121-million is due to improved earnings and the Kenai award and settlement.

Financial Position

Cash balances increased \$225-million to end the year at \$425-million, largely attributable to cash provided by operating activities.

Consolidated inventories have increased by \$79-million compared to the prior year. The majority of this increase is comprised of an additional 175-thousand tonnes of ammonia inventory resulting from the late harvest and early winter in Western Canada and the Northern Plains. Lower application rates in the fall 2004 season should result in strong application demand in the 2005 spring season.

Other liabilities are up largely due to shutdown costs accrued for the intended closure of the Kenai, Alaska nitrogen facility in November 2005.

BUSINESS SEGMENT PERFORMANCE

Retail

- In the fourth quarter of 2004, we integrated our North and South America Retail segments into one Retail segment. The change was a reflection of organizational and operational changes that aligned and integrated our South America Retail segment with North America Retail.
- Fourth quarter 2004 Retail EBIT was up \$11-million over the same period last year. The increase is attributable to both growth in fertilizer sales prices and volumes.
- Lower expenses relative to liability claims and accounts receivable write-offs also contributed to the EBIT increase.

North America Wholesale

- Wholesale EBIT for the fourth quarter of 2004 was \$140-million, up \$313-million from a negative EBIT of \$173-million for the same period last year. Excluding Kenai related items from both years, Wholesale EBIT for the fourth quarter was \$95-million in 2004 and \$62-million in 2003.
- Gross profit in the fourth quarter of 2004 was up by \$41-million over the same quarter last year, with increased margin per tonne in every product category. In the quarter, Potash experienced the largest increase in gross profit of \$17-million, primarily due to higher prices. The growth in Potash earnings is a reflection of continued tight supply/demand balance, both internationally and in North America. Phosphate gross margins were up \$11-million due to

higher prices for Monoammonium Phosphate (MAP) driven by higher ammonia prices. Total nitrogen increase in gross profit of \$13-million was largely attributed to a \$21-million growth in urea gross profit, a reflection of tight supply/demand fundamentals both internationally and in North America. This was partially offset by a \$13-million decrease in ammonia gross profit comprised of lower demand due to poor weather conditions in North America and increased cost of product attributable to higher gas costs.

- Expenses (income) in the fourth quarter of 2004 include \$45-million of Kenai related income, comprised of liquidated damages from the Arbitration Panel award and a gain from the settlement of litigation. The prior year fourth quarter includes a Kenai asset impairment pre-tax expense of \$235-million. Excluding these Kenai related items from both years, expenses (income) for Wholesale were up by \$8-million in the fourth quarter of 2004 compared to the same period of 2003, largely relating to Kenai Earn-out accrued prior to our settlement with Unocal in December, 2004.

South America Wholesale

- Wholesale EBIT was \$23-million and gross profit was \$28-million for the fourth quarter in 2004, up \$7-million and \$6-million respectively from the same period last year. The increase is primarily attributable to higher urea international prices which impacted both domestic and export selling prices, consistent with tightened supply/demand balance.

Other

- EBIT for our Other non-operating business segment for the fourth quarter of 2004 was up \$5-million over the same period last year. This increase is largely related to foreign exchange gains on the translation of U.S. dollar working capital in our Canadian parent company.

SELECTED QUARTERLY INFORMATION

(Unaudited, in millions of U.S. dollars, except per share information)

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net sales	720	672	1,011	435	637	561	929	372
Gross Profit	254	231	283	142	204	172	252	111
Net earnings (loss)	102	87	75	12	(109)	25	69	(6)
Earnings (loss) per share								
-basic	0.76	0.65	0.56	0.07	(0.89)	0.18	0.53	(0.07)
-diluted	0.71	0.60	0.52	0.07	(0.89)	0.17	0.47	(0.07)

The fertilizer business is seasonal in nature. Consequently, quarter-to-quarter results are not directly comparable.

NON-GAAP MEASURES

In the discussion of our performance for the quarter, in addition to the primary measures of earnings and earnings per share, we make reference to EBIT (earnings before interest expense and income taxes) and EBITDA (earnings before interest expense, income taxes, depreciation, amortization and asset impairment). We consider EBIT and EBITDA to be useful measures of performance because income tax jurisdictions and business segments are not synonymous, and we believe that allocation of income tax charges distorts the comparability of historical performance for the different business segments. Similarly, financing and related interest charges cannot be allocated to all business segments on a basis that is meaningful for comparison with other companies. EBIT and EBITDA measures are also used extensively in the covenants relating to our financing arrangements.

EBIT and EBITDA are not recognized measures under GAAP, and our method of calculation may not be comparable to other companies. EBIT should therefore not be used as an alternative to net earnings (loss) determined in accordance with GAAP as an indicator of our performance. Similarly, EBITDA should not be used as an alternative to cash provided by (used in) operating activities as determined in accordance with GAAP.

KEY RISKS AND UNCERTAINTIES

Looking Forward to the First Half of 2005

As Agrium looks forward to the First Half of 2005, there are a number of factors that may positively impact our future results:

- In 2004, above average Canadian grain production and record U.S. corn and soybean production increased soil nutrient removal and boosted U.S. farm income to record high levels.
- Western Canadian moisture conditions are significantly improved compared to this time last year. In addition, fall application in Western Canada and several regions of the U.S. was cut short in 2004 as a result of weather-related constraints. These factors should support strong nutrient demand during the upcoming spring season.
- North American potash inventories are down as of December 2004 compared to December 2003. For urea, the pace of offshore imports has significantly lagged behind last year, while producer inventories remain similar on a year-over-year basis.
- The Chinese government has announced the elimination of the 11 percent Value Added Tax rebate on Chinese urea exports and imposed the equivalent of a \$31.50 per tonne tax on Chinese exports effective January 1, 2005. Both measures should limit Chinese urea exports.
- The recent finding of Asian rust in the U.S. could support more corn and cotton acreage at the expense of soybeans. This would be positive for fertilizer use, especially nitrogen. Asian rust also has the potential to increase chemical application on soybeans, which would be positive for chemical revenues in our U.S.-based retail operations.

Offsetting these positive indicators are some negative factors that may adversely impact future results:

- North American crop prices are lower than last year at this time due to the significant increase in global and U.S. grain and oilseed production during 2004. Despite this increased production, global grain stocks remain well below historical levels.
- International ammonia prices declined in January 2005 in part due to a build up of supplies in key exporting regions.
- North American producer inventories of phosphate and ammonia were higher as of December 2004 compared to December 2003.
- High and volatile North American natural gas prices could negatively impact North America Wholesale's margins.
- The Canadian dollar remains strong relative to the U.S. dollar, which negatively impacts Agrium's Canadian dollar-denominated costs.

OTHER

Agrium Inc. is a leading global producer and marketer of agricultural nutrients and industrial products and a major retail supplier of agricultural products and services in both North and South America. Agrium produces and markets three primary groups of nutrients: nitrogen, phosphate and potash as well as micronutrients. Agrium's strategy is to grow through incremental

expansion of its existing operations and acquisitions as well as the development, commercialization and marketing of new products and international opportunities.

Certain statements in this press release constitute forward-looking statements. Such forward-looking statements involve known and unknown risks and uncertainties, including those referred to in the management discussion and analysis section of the Corporation's most recent annual report to shareholders, which may cause the actual results, performance or achievements of the Corporation to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to, weather conditions, the future supply, demand, price level and volatility of natural gas, future prices of nitrogen, phosphate and potash, the differential pricing of natural gas in various markets, the future gas prices and availability at Kenai, the exchange rates for U.S., Canadian, Argentine, and Chilean currencies, South American government policy, South American domestic fertilizer consumption, future fertilizer inventory levels, future nitrogen, potassium and phosphate consumption in North America, future crop prices, future levels of nitrogen imports into North America and future additional fertilizer capacity and operating rates. Agrium disclaims any intention or obligation to update or revise any forward-looking information as a result of new information or future events.

A WEBSITE SIMULCAST of the 2004 4th Quarter Conference Call will be available in a listen-only mode beginning Thursday, February 10th at 9:30 a.m. MT (11:30 a.m. ET). Please visit the following website: www.agrium.com

AGRIUM INC.
Consolidated Statements of Operations and Retained Earnings
(Millions of U.S. dollars, except per share information)
(Unaudited)

	Three months ended		Twelve months ended	
	December 31.		December 31.	
	2004	2003	2004	2003
Sales	\$ 766	\$ 677	\$ 3,001	\$ 2,630
Direct freight	46	40	163	131
Net sales	720	637	2,838	2,499
Cost of product	466	433	1,928	1,760
Gross profit	254	204	910	739
Expenses (income)				
Selling, general and administrative	83	82	301	286
Depreciation and amortization	39	39	156	140
Kenai award and settlement (note 2)	(45)	-	(86)	-
Asset impairment	-	235	-	235
Royalties and other taxes	6	4	29	17
Other expenses	3	12	43	40
	86	372	443	718
Earnings (loss) before interest expense and income taxes	168	(168)	467	21
Interest on long-term debt	13	14	51	58
Other interest	3	1	4	5
Earnings (loss) before income taxes	152	(183)	412	(42)
Current income taxes (recovery)	24	(13)	99	22
Future income taxes (reduction)	26	(61)	37	(43)
Income taxes	50	(74)	136	(21)
Net earnings (loss)	102	(109)	276	(21)
Retained earnings - beginning of period	305	264	145	191
Common share dividends declared	(7)	(7)	(14)	(14)
Preferred securities charges	(2)	(3)	(9)	(11)
Retained earnings - end of period	\$ 398	\$ 145	\$ 398	\$ 145
Earnings (loss) per share (note 7)				
Basic	\$ 0.76	\$ (0.89)	\$ 2.04	\$ (0.25)
Diluted	\$ 0.71	\$ (0.89)	\$ 1.91	\$ (0.25)

AGRIUM INC.
Consolidated Statements of Cash Flows
(Millions of U.S. dollars)
(Unaudited)

	Three months ended		Twelve months ended	
	December 31,		December 31,	
	2004	2003	2004	2003
Operating				
Net earnings (loss)	\$ 102	\$ (109)	\$ 276	\$ (21)
Items not affecting cash				
Depreciation and amortization	39	39	156	140
Asset impairment	-	235	-	235
Kenai award and settlement (note 2)	(36)	-	(36)	-
Proceeds on settlement (note 2)	25	-	25	-
Gain on disposal of assets	(4)	-	(6)	(5)
Future income taxes (reduction)	26	(61)	37	(43)
Foreign exchange	(1)	(3)	(5)	(8)
Net change in non-cash working capital	39	(32)	(8)	(114)
Other operating	1	1	10	2
Cash provided by operating activities	<u>191</u>	<u>70</u>	<u>449</u>	<u>186</u>
Investing				
Capital expenditures	(33)	(32)	(82)	(99)
Decrease (increase) in other assets	(7)	5	(14)	3
Proceeds from disposal of assets and investments	7	-	10	12
Net change in non-cash working capital	-	8	-	26
Other	3	-	7	10
Cash used in investing activities	<u>(30)</u>	<u>(19)</u>	<u>(79)</u>	<u>(48)</u>
Financing				
Common shares	4	5	12	6
Bank indebtedness repayment	(1)	-	-	(1)
Long-term debt repayment	(36)	(24)	(134)	(27)
Common share dividends paid	-	-	(14)	(14)
Preferred securities charges paid	(2)	(3)	(9)	(11)
Cash used in financing activities	<u>(35)</u>	<u>(22)</u>	<u>(145)</u>	<u>(47)</u>
Increase in cash and cash equivalents	126	29	225	91
Cash and cash equivalents - beginning of period	299	171	200	109
Cash and cash equivalents - end of period	<u>\$ 425</u>	<u>\$ 200</u>	<u>\$ 425</u>	<u>\$ 200</u>

AGRIUM INC.
Consolidated Balance Sheet
(Millions of U.S. dollars)
(Unaudited)

	As at	
	December 31,	
	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	\$ 425	\$ 200
Accounts receivable	388	314
Inventories	447	368
Prepaid expenses	56	60
	<u>1,316</u>	<u>942</u>
Capital assets	1,239	1,260
Other assets	77	71
Future income tax assets	24	-
	<u>\$ 2,656</u>	<u>\$ 2,273</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 472	\$ 404
Current portion of long-term debt	60	121
	<u>532</u>	<u>525</u>
Long-term debt		
Recourse debt	471	503
Non-recourse debt	69	111
	<u>540</u>	<u>614</u>
Other liabilities	257	181
Future income tax liabilities	201	132
	<u>1,530</u>	<u>1,452</u>
Shareholders' equity		
Share capital		
Authorized: unlimited common shares and preferred securities		
Issued:		
Common shares: 2004 - 132-million (2003 - 127-million)	553	490
Preferred securities:		
8% Redeemable: 2004 - seven million (2003 - seven million) (note 5)	172	172
6% Convertible, redeemable: 2004 - nil (2003 - two million) (note 5)	-	50
Contributed surplus	2	1
Retained earnings	398	145
Cumulative translation adjustment	1	(37)
	<u>1,126</u>	<u>821</u>
	<u>\$ 2,656</u>	<u>\$ 2,273</u>

AGRIUM INC.
Summarized Notes to the Consolidated Financial Statements
For the twelve months ended December 31, 2004
(Millions of U.S. dollars, except per share amounts)
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

The Corporation's accounting policies are in accordance with accounting principles generally accepted in Canada and are consistent with those outlined in the annual audited financial statements except where stated below. These interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Corporation's audited consolidated financial statements for the year ended December 31, 2003. In management's opinion, the interim consolidated financial statements include all adjustments necessary to present fairly such information.

Certain comparative figures have been reclassified to conform to the current year's presentation.

2. KENAI AWARD AND SETTLEMENT

The following amounts were recorded during 2004 relating to the arbitration award and settlement of legal claims in our dispute with Union Oil Company of California (Unocal):

	2004	
	Three months ended December 31	Twelve months ended December 31
Arbitration award (a)	\$ 9	\$ 50
Settlement of legal claims (b)	36	36
	<u>\$ 45</u>	<u>\$ 86</u>

(a) Arbitration award

During 2004, the Corporation was awarded liquidated damages with respect to a dispute with Unocal over gas supply obligations to our Kenai, Alaska nitrogen facility. The Arbitration Panel awarded the Corporation \$37-million plus interest for damages up to April 2004. An additional \$4-million was received for the period May to September 2004 and \$9-million for the period October to December 2004. The total liquidated damages recorded for the year totaled \$50-million.

(b) Settlement of legal claims

In December of 2004, the Corporation settled its dispute with Unocal over obligations under the Purchase and Sale Agreement, pursuant to which the Corporation acquired its Kenai, Alaska nitrogen facility. The settlement agreement establishes a definitive gas supply obligation from Unocal to the Kenai facility up until October 31, 2005.

The net gain of \$36-million recorded in the fourth quarter of 2004 was comprised of the following:

	Three and twelve months ended December 31	
	2004	
Net cash received	\$	25
Earn-out adjustment (2001 - 2004)		81
Adjustments related to termination of gas supply		(70)
Net gain	<u>\$</u>	<u>36</u>

AGRIUM INC.
Summarized Notes to the Consolidated Financial Statements
For the twelve months ended December 31, 2004
(Millions of U.S. dollars, except per share amounts)
(Unaudited)

3. BANK INDEBTEDNESS

In May 2004, Agrium Inc. and its wholly owned subsidiary, Agrium U.S. Inc., entered into a \$450-million three-year syndicated revolving unsecured credit facility. The new credit agreement replaced Agrium Inc.'s \$225-million credit facility due in May 2004 and Agrium U.S. Inc.'s \$56-million credit facility due in December 2004.

Under the terms of the agreement, Agrium Inc. and Agrium U.S. Inc. may borrow a maximum principal amount of \$325-million and \$125-million respectively. Interest rates are at either Canadian prime rate plus a variable margin, U.S. base rate established by a bank plus a variable margin, LIBOR plus a variable margin or bankers' acceptance rate plus a variable margin, at the election of the borrower.

The credit facility requires that Agrium Inc. maintain certain financial ratios and other covenants.

4. EMPLOYEE FUTURE BENEFITS

The total net employee future benefits expense for the Corporation's pension and post-retirement benefit plans are computed as follows:

	Three months ended December 31,		Twelve months ended December 31,	
	2004	2003	2004	2003
Defined benefit pension plans	\$ 4	\$ 1	\$ 10	\$ 7
Post-retirement benefit plans	3	2	7	5
Defined contribution pension plans	3	3	11	10
Total expense	<u>\$ 10</u>	<u>\$ 6</u>	<u>\$ 28</u>	<u>22</u>

This expense is reflected in our cost of product and general and administrative expenses.

5. SHARE CAPITAL

In January 2005, the Corporation announced its intention to redeem the \$175-million, eight percent redeemable preferred securities for cash on February 14, 2005. The redemption price will equal the principal amount of the securities plus accrued and unpaid interest to the date of redemption.

In January 2004, pursuant to the Corporation's plan to redeem the six percent preferred securities, all holders of the convertible, redeemable preferred securities elected to convert the securities into common shares at the stated conversion price of \$11.9677 per share, resulting in the issuance of an additional 4.18 million common shares.

AGRIUM INC.
Summarized Notes to the Consolidated Financial Statements
For the twelve months ended December 31, 2004
(Millions of U.S. dollars, except per share amounts)
(Unaudited)

6. STOCK BASED COMPENSATION

The Corporation began prospectively expensing the fair value of stock options granted in 2003 over their vesting period. In accordance with the prospective method of adoption, the Corporation has recorded no compensation expense for stock options granted prior to January 1, 2003 and will continue to provide pro forma disclosure of the effect on net earnings (loss) and earnings (loss) per share had the fair value been expensed. The following table summarizes the pro forma disclosure for stock options granted prior to 2003 that have not been expensed.

	Three months ended December 31,			
	2004		2003	
	As Reported	Pro forma	As Reported	Pro forma
Net earnings (loss)	\$ 102	\$ 101	\$ (109)	\$ (109)
Earnings (loss) per share				
Basic	\$ 0.76	\$ 0.75	\$ (0.89)	\$ (0.89)
Diluted	\$ 0.71	\$ 0.70	\$ (0.89)	\$ (0.89)

	Twelve months ended December 31,			
	2004		2003	
	As Reported	Pro forma	As Reported	Pro forma
Net earnings (loss)	\$ 276	\$ 272	\$ (21)	\$ (26)
Earnings (loss) per share				
Basic	\$ 2.04	\$ 2.01	\$ (0.25)	\$ (0.29)
Diluted	\$ 1.91	\$ 1.89	\$ (0.25)	\$ (0.29)

AGRIUM INC.
Summarized Notes to the Consolidated Financial Statements
For the twelve months ended December 31, 2004
(Millions of U.S. dollars, except per share amounts)
(Unaudited)

7. EARNINGS (LOSS) PER SHARE

The following table summarizes the computation of net earnings (loss) per share:

	Three months ended December 31,		Twelve months ended December 31,	
	2004	2003	2004	2003
Numerator:				
Net earnings (loss)	\$ 102	\$ (109)	\$ 276	\$ (21)
Preferred securities charges (net of tax)	(2)	(3)	(9)	(11)
Numerator for basic earnings (loss) per share	<u>100</u>	<u>(112)</u>	<u>267</u>	<u>(32)</u>
Preferred securities charges (net of tax) (a)	2	-	9	-
Numerator for diluted earnings (loss) per share	<u>\$ 102</u>	<u>\$ (112)</u>	<u>\$ 276</u>	<u>\$ (32)</u>
Denominator:				
Weighted average denominator for basic earnings (loss) per share	<u>132</u>	<u>126</u>	<u>131</u>	<u>126</u>
Dilutive instruments:				
Stock options (a)	2	-	1	-
Preferred securities converted to common shares				
\$175-million, eight percent (a)	10	-	12	-
\$50-million, six percent (note 5)(a)	-	-	-	-
Denominator for diluted earnings per share	<u>144</u>	<u>126</u>	<u>144</u>	<u>126</u>
<i>Basic earnings (loss) per share</i>	<u>\$ 0.76</u>	<u>\$ (0.89)</u>	<u>\$ 2.04</u>	<u>\$ (0.25)</u>
<i>Diluted earnings (loss) per share</i>	<u>\$ 0.71</u>	<u>\$ (0.89)</u>	<u>\$ 1.91</u>	<u>\$ (0.25)</u>

(a) For diluted earnings per share, these dilutive instruments are added back only when the impact of the instrument is dilutive to basic earnings per share.

There were 132 million common shares outstanding at December 31, 2004 (2003 - 127 million). As at December 31, 2004, the Corporation has outstanding approximately eight million options to acquire common shares.

AGRIUM INC.
Summarized Notes to the Consolidated Financial Statements
For the twelve months ended December 31 2004
(Millions of U.S. dollars, except per share amounts)
(Unaudited)

8. SEASONALITY

The fertilizer business is seasonal in nature. Sales are concentrated in the spring and fall planting seasons while produced inventories are accumulated throughout the year. Cash collections generally occur after the planting seasons in North and South America.

9. SEGMENTED INFORMATION

The Corporation's primary activity is the production and wholesale marketing of nitrogen, potash and phosphate and the retail sales of fertilizers, chemicals and other agricultural inputs and services. The Corporation operates principally in Canada, the United States and Argentina.

Net sales between segments are accounted for at prices, which approximate fair market value and are eliminated on consolidation. The reportable segment entitled "Other" includes Corporate functions and inter-segment eliminations.

In the fourth quarter of 2004, we integrated our North and South America Retail segments into one Retail segment. Prior periods have been restated for comparative purposes.

AGRIUM INC.
Segmentation
(unaudited – millions of U.S. dollars)

Three Months Ended December 31

	Wholesale											
	Retail		North America				South America		Other		Total	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Net sales - external	\$ 219	\$ 206	\$ 464	\$ 401	\$ 37	\$ 30	\$ -	\$ -	\$ 720	\$ 637		
- inter-segment	-	-	36	29	2	1	(38)	(30)	-	-		
Total net sales	219	206	500	430	39	31	(38)	(30)	720	637		
Cost of product	146	135	349	320	11	9	(40)	(31)	466	433		
Gross profit	73	71	151	110	28	22	2	1	254	204		
Gross profit %	33%	34%	30%	26%	72%	71%	5%	3%	35%	32%		
Selling Expenses	\$ 58	\$ 61	\$ 5	\$ 4	\$ -	\$ -	\$ (1)	\$ (2)	\$ 62	\$ 63		
EBITDA (1)	\$ 21	\$ 11	\$ 169	\$ 91	\$ 27	\$ 20	\$ (10)	\$ (16)	\$ 207	\$ 106		
EBIT (2)	\$ 17	\$ 6	\$ 140	\$ (173)	\$ 23	\$ 16	\$ (12)	\$ (17)	\$ 168	\$ (168)		

Twelve Months Ended December 31

	Wholesale											
	Retail		North America				South America		Other		Total	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Net sales - external	\$ 1,114	\$ 1,015	\$ 1,594	\$ 1,377	\$ 130	\$ 107	\$ -	\$ -	\$ 2,838	\$ 2,499		
- inter-segment	-	-	109	88	13	9	(122)	(97)	-	-		
Total net sales	1,114	1,015	1,703	1,465	143	116	(122)	(97)	2,838	2,499		
Cost of product	798	717	1,211	1,106	41	34	(122)	(97)	1,928	1,760		
Gross profit	316	298	492	359	102	82	-	-	910	739		
Gross profit %	28%	29%	29%	25%	71%	71%	0%	0%	32%	30%		
Selling Expenses	\$ 222	\$ 214	\$ 17	\$ 15	\$ 1	\$ 1	\$ (3)	\$ (3)	\$ 237	\$ 227		
EBITDA (2)	\$ 99	\$ 85	\$ 465	\$ 285	\$ 98	\$ 78	\$ (39)	\$ (52)	\$ 623	\$ 396		
EBIT (1)	\$ 81	\$ 66	\$ 349	\$ (49)	\$ 83	\$ 63	\$ (46)	\$ (59)	\$ 467	\$ 21		

(1) Earnings (loss) before interest expense, income taxes, depreciation, amortization and asset impairment.

(2) Earnings (loss) before interest expense and income taxes.

AGRIUM INC.
Product Lines
Three Months Ended December 31
(unaudited – millions of U.S. dollars)

	2004					2003				
	Net Sales	Gross Profit	Sales Tonnes (000's)	Selling Price (\$/Tonne)	Margin (\$/Tonne)	Net Sales	Gross Profit	Sales Tonnes (000's)	Selling Price (\$/Tonne)	Margin (\$/Tonne)
North America Wholesale										
Nitrogen (1)										
Ammonia	\$ 100	\$ 24	325	\$ 308	\$ 74	\$ 130	\$ 37	485	\$ 268	\$ 76
Urea	166	53	649	256	82	123	32	623	197	51
Nitrate, Sulphate and Other	71	17	352	202	48	59	12	358	165	34
Total Nitrogen	337	94	1,326	254	71	312	81	1,466	213	55
Phosphate	101	23	370	273	62	74	12	313	236	38
Potash (2)	62	34	464	134	73	44	17	436	101	39
	500	151	2,160	231	70	430	110	2,215	194	50
South America Wholesale (1)	39	28	149	262	188	31	22	160	194	138
Retail (3)										
Fertilizers	131	28				120	26			
Chemicals	62	32				61	32			
Other	26	13				25	13			
	219	73				206	71			
Inter-segment	(38)	2				(30)	1			
Total	\$ 720	\$ 254				\$ 637	\$ 204			

(1) International nitrogen sales were 437,000 tonnes (2003 – 500,000) net sales were \$110-million (2003 – \$90-million) and gross profit was \$62-million (2003 – \$47-million) for the three months ended December 31.

(2) International potash sales were 200,000 tonnes (2003 – 138,000) net sales were \$22-million (2003 – \$10-million) and gross profit was \$14-million (2003 – \$5-million) for the three months ended December 31.

(3) International Retail net sales were \$37-million (2003 – \$30-million) and gross profit was \$5-million (2003 – \$7-million) for the three months ended December 31.

AGRIUM INC.
Product Lines
Twelve Months Ended December 31
(unaudited - millions of U.S. dollars)

	2004					2003				
	Net Sales	Gross Profit	Sales Tonnes (000's)	Selling Price (\$/Tonne)	Margin (\$/Tonne)	Net Sales	Gross Profit	Sales Tonnes (000's)	Selling Price (\$/Tonne)	Margin (\$/Tonne)
North America Wholesale										
Nitrogen (1)										
Ammonia	\$ 397	\$ 113	1,438	\$ 276	\$ 79	\$ 382	\$ 96	1,555	\$ 246	\$ 62
Urea	499	134	2,211	226	61	423	100	2,220	191	45
Nitrate, Sulphate and Other	284	68	1,510	189	45	239	58	1,381	173	42
Total Nitrogen	1,180	315	5,159	229	61	1,044	254	5,156	202	49
Phosphate	309	71	1,181	262	60	261	44	1,090	239	40
Potash (2)	214	106	1,796	119	59	160	61	1,662	96	37
	1,703	492	8,136	209	60	1,465	359	7,908	185	45
South America Wholesale (1)	143	102	634	226	161	116	82	653	178	126
Retail (3)										
Fertilizers	556	131				468	117			
Chemicals	416	118				416	119			
Other	142	67				131	62			
	1,114	316				1,015	298			
Inter-segment	(122)	-				(97)	-			
Total	\$ 2,838	\$ 910				\$ 2,499	\$ 739			

(1) International nitrogen sales were 1,881,000 tonnes (2003 - 1,991,000) net sales were \$393-million (2003 - \$319-million) and gross profit was \$206-million (2003 - \$155-million) for twelve months ended December 31.

(2) International potash sales were 730,000 tonnes (2003 - 570,000) net sales were \$71-million (2003 - \$43-million) and gross profit was \$42-million (2003 - \$22-million) for twelve months ended December 31.

(3) International Retail net sales were \$118-million (2003 - \$92-million) and gross profit was \$22-million (2003 - \$17-million) for twelve months ended December 31.