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1885 SRES NATURAL GAS TRANS: 3/31/82 (KIDDER PEABODY)

Q.: Try to, ... question that is that all the information I have is, you mentioned the supply of natural gas on a shortrun basis and ... surplus and a ... do not have, but a lot of good information indicates that there is for a good long time in the future, not a shortage of natural gas, and that fits into marketability question also, would you just ...

MacKay: All right, let me tackle the last part first perhaps, including in context. One very significant example to me that our consultant has raised in respect to his question of the shortage of gas or the surplus of gas, is the amount of reserves in one area of the United States, just to use an example, or to make a point of how rapidly existing reserves are declining and how difficult the job is just to keep up with those declines, the South Louisiana area of the United States has about 35% of the reserves, excuse me, that's turned around, it's 25% of the reserves, but we're taking 35% of our annual production from those reserves in just one small geographic area, that's 7 trillion feet out of the 20 approximately each year is being produced out of South Louisiana. That rate of depletion is about 16% per year of the reserves that are there, so it's a quarter of our reserves and we're producing at that high rate. Now that'll decline, you know at that rate it would be gone in five years unless it's a huge amount of reserves, but it's only declined for, but it's nevertheless an example of the very important decline. A lot of the reserves that are being added, such as the well known overthrust belt are very low producible reserves, so you have to add a lot more reserves to replace what you're taking from South Louisiana, than what's in South Louisiana from a reserve standpoint. So there is a very precipitous decline particularly in the latter part of this decade, and that creates a good part of the need that I'm discussing here.

The marketability question, as I mentioned we feel confident that through a combination of those three things that first, either the gas may be incrementally saleable anyway, that there's, you know we had three major disruptions in Mideast in the decade of the 70's and it only takes one of those to add 50% or 100% to the price of oil, and so we're still in that tenuous situation, and that price affects clearing price for gas in the United States, whereas oil prices rise so does the clearing price for gas.

Secondly, we have this ability to average the cost of Alaskan gas in with other supplies, and then, third, we have this levelization method to move costs from the early years to the back years. Now we're not the only ones that have to be satisfied on marketability, the shippers, the people that are committing themselves to buy this gas have to be satisfied, the banks have to be satisfied, and so on. So all of this will be reviewed, but we're confident that we have the tools to assure that Alaska gas will be marketable.

Your last point, and I think first question in terms of the pre-billing issue, perhaps, to put that in context the first of all, nothing can happen under the legislation as it has been passed before a date certain and that date certain is the expected date of completion of the whole project, Canada and Alaska. That date is to be set by the Federal

Energy Regulatory Commission consulting with the Federal Inspector. So it's an independent objective outside look, it's not the project people setting the date. So they're going to be very concerned to assure that that date is set at a time that can be met. Right now we're talking late 1986 or 1987, then nothing could happen in terms of billing to present consumers before that date. Now after that date, if one of three of the major segments of the project is completed, but others are not, the three segments are the Conditioning Plant, the Alaska pipeline, and the Canadian pipeline as a whole. If one of those is completed, let's say Canada's complete on the target date, but for some reason we've had a delay in Alaska on Conditioning Plant, then present consumers at that time could be charged for the cost of the Canadian system, because it is now complete and ready for service. As I mentioned early on, we think the chances of this kind of thing occurring are remote because we will be close to coordinating the schedule, we know a lot now about what is schedule sensitive and how we can accommodate problems as they occur, so we think the chances of this occurring are remote. Now, however if you took that illumination of that risk to get this project done on a private basis, we're trying to do that, that seems to us to be a small risk for the consumer to take in order to assure the very large benefits that he will get over the life of the project to get this gas supply, and that was the ultimate decision that a lot of the Congressmen decided was important from their perspective.

Fahrenkamp: Are there further questions? Representative Cotton.

Cotton: I have a couple questions, if you're trying to get this thing over with in a hurry I won't ask any questions.

Fahrenkamp: I'm not, I'm just smiling, I have a 4:30 deadline and we have three other people to hear from.

Cotton: Okay I got a couple questions, I'll try to make them real brief. You mentioned as of end of 81 the company had spent 600 million dollars on the project, does that figure include the cost of the so-called prebill in the Western and Eastern Legs so that prebill?

MacKay: No it does not. That's strictly the Alaskan partnership that includes none of the lower 48 systems.

Cotton: None of the Canadian?

MacKay: None of the Canadian.

Cotton: So of that money and all the people you're talking about that were working, the 1400 average, the 1800 workforce peak, that was all dealing with the Alaskan portion?

MacKay: Correct, does not include the Canadians or does not include all the work going on on the prebill. That's all separate. And the prebill itself interestingly which between the two countries is between two and three billion dollars, two and a half say, the Eastern Leg in the United States which was a total of about one and a half billion dollars is the largest private again financing ever done on the gas

pipeline in the United States, where again we tend to forget the magnitude of some of the things we're dealing with, but that was done and done successfully on the part of the . . .

Cotton: I've been playing around with your figures here, correct me if I'm wrong, 25 to 33% of those jobs were in Alaska and of those jobs 80% were Alaskans, so I get down to about 1 of 8 of the jobs that have been associated with the pipeline in Alaska have been Alaskans who have been hired, would you say that I've unfairly manipulated your figures by saying that 1 of 8 jobs are given to Alaskans?

MacKay: Well, I think yes it is unfair and I think the fair way to look at it is what have we done in respect to the people that are located in Alaska. You know it's tough to say you can attract Alaskans as much as they love this country up here to California or Utah or Washington to work on the project, or Houston, but of the people that have been brought on of the total complement in Alaska, the key figure is this 75-80% have been Alaskans. We think that's darn good performance.

Cotton: Of the jobs that are in Alaska?

MacKay: That's right.

Cotton: A couple of real quick questions, right now the Western Leg is sending Canadian or Alberta gas to California, is that correct, as it's operating as of the first of October?

MacKay: That's correct.

Cotton: And the other Leg will be operating this fall, last thing that the National Energy Board in Canada has allowed, as only a certain timeframe for a commitment of Alberta gas that you're able to use, I understood it's about five years, is that correct?

MacKay: The licenses under which that gas is moving varies between the two legs but it's about an average of six.

Cotton: Okay, so what would happen if the National Energy Board didn't allow any further export from Alberta to the West Coast of the United States, would that pipeline then have to just wait until the Alaskan section got through, or I suppose you'd pursue other alternatives, but that would be the point it would be empty until Alaska's gas came on board, is that correct?

MacKay: That could happen, we don't expect it to happen, the National Energy Board is right this year having what they call an omnibus export proceeding to look at all exports to the United States and our group is back in looking for an extension of those licenses to go further because companies in our group need both the Canadian and Alaskan gas which comes back to the question of need and marketability that they're really pursuing both supplies. The contracts are for 12 years, initial term of the contracts is 12 years and we're trying to extend the licenses.

Cotton: Okay, so probably then your goal is to get Alaskan gas to where in Alberta is the hookup there?

MacKay: A place called James River.

Cotton: James River so you want to get Alaskan gas to James River probably sometime in 1987 or 1988, is that what you're still shooting at?

MacKay: Well our current schedule is late 1986, we're really currently about reevaluating that in light of where we are, what happened on the waiver package and we'll be able to address substantially where we are on that schedule next month.

Cotton: Do you expect to have it later than late 86 then?

MacKay: That's very tight. That schedule is very tight.

Cotton: Late 86 is very tight, does that mean that you still expect to really meet that?

MacKay: It could be met but it's very improbable at this point.

Cotton: You don't want to, your most probable date -- if I step over these provinces of sensitivity please let me know.

MacKay: Yes, no we really are very thoroughly re-evaluating that in terms of the steps on financing, regulatory steps and construction, and we will be in a position to lay that out particularly to the Federal Energy Regulatory Commission next month.

Cotton: In terms of other re-evaluations, when somebody asks you these days what is the total cost of the project, what are you saying these days?

MacKay: Well, let me try to put that in context, and I'll try to deal with some ranges because I think that's the best way to get a feel for this, there's a lot of ways to present capital costs so one must be sure they understand what is being presented. The first figures I'll give you are 1980 dollars so we are not including either contingency or interest on debt during construction in these figures.

Cotton: Without contingency -

MacKay: Excuse me, not contingency, inflation or the interest on debt during construction.

Cotton: Without interest on debt during construction?

MacKay: The total project, including Canada and the lower 48 and including the facilities now under construction, the prebill, varies from about 17.5 billion dollars to 23 billion dollars with and without contingencies, in other words, in the lower figure there are no contingencies and in the higher figure we have provided both what we call normal contingency and abnormal events.

Cotton: 17 to 23 is the range without inflation and without interest on debt during the construction period?

MacKay: That's right.

Cotton: So you're gonna add those to, just putting it in perspective, what you're doing?

MacKay: That's right. Now to bring those figures in, of course one has to assume inflation rates and interest costs which is at best a difficult thing to prophecy.

Cotton: Excuse me, just one real quick ..., since the Conditioning Plant is now part of the System, I assume you're adding the cost of the Conditioning Plant in with the figures you have just given me?

MacKay: Yes, the Conditioning Plant is included in those figures.

Q.: Excuse me.

MacKay: Yes.

Q.: In the 17 and a half to 23, does that, did you say that that included the Eastern Leg and the Western Leg and the prebuilt system?

MacKay: ...

Q.: ... I think that's what you said for the Eastern Leg, or over a billion anyway, that somewhere between a billion and a half, two billion dollars has been already spent or committed?

MacKay: Yes. That's right, and now when I get to inflated numbers it's easier to deal with that because those facilities are being built early so I'll put that in perspective with you on the total project. Now, if we look at inflation rates in the range of say 7 to 11% and interest rates in the range of 10 to 14%, the costs of the total project again would vary from roughly 39 billion dollars to 48 billion dollars. I want to stress there that you can, to see the importance that inflation and interest have on the total project costs, as you can see it's over half of the cost, now of that range about two and a half, or a little over to 2.7 billion, depending on the ultimate cost of the Eastern Leg will have been the prebill, so the net cost after prebill for the completion is in the range of say 36 billion to 45 billion dollars, and I'm sure you have seen publicized the figure of around 40 which is generally in the middle of that range. Again that's inflated dollars and including interest on debt and it's important to recognize how big a share of the total cost that is.

Cotton: Is that a recent estimate and do you expect to have a re-evaluation of those numbers any time soon?

MacKay: We are as a group of sponsors very carefully addressing what amount of money needs to be financed and that involves estimates and inflation and so on. I don't expect that that would be outside of this

range that I just presented, that that's pretty good part of the overall financing activity. This estimate by the way, was the base behind this estimate particularly the pipeline was made in 1980 was filed with the FERC in mid-1980 and we filed some recent adjustments to that base but that base has held very well during the course of the additional field programs that we've done and engineering work we've done, so we're confident in our cost estimate.

Cotton: One final question, you finished your remarks with a discussion of what forms the State's participation might take and you were very careful to phrase it in a way that wouldn't offend the legislators up here, I suppose, but you suggested though both times that the debt was the area that the State should consider if we were wanting to know what your preference was, and you didn't mention equity, and maybe I just misunderstood what you had to say but you considered short term or project debt the first preference, long term debt the second preference, and please correct me if I'm wrong, and then you didn't make any mention of an equity investment by the State, maybe you could expand on that a little bit as to why you left out equity, or in fact did you leave that out, as more -

MacKay: In terms of our preference, yes, and there are a couple of reasons, one, we are able to raise the equity with the present group's sponsors that are supporting the project that we're able to include the producers as we may now do in the, under the waiver package that was approved, so our difficulty in putting the plan together is not with equity, we can put together the equity appropriately.

Secondly, we see some difficulty from the State's standpoint in participating in equity because of its dual role as regulator as well as investor. Now there may be some ways to get around that that could work, and we're certainly open to discussions of any nature, I don't want to foreclose any discussion that may be fruitful in this area.

Thirdly, we had observed and this was back in 79 but when Governor Hammond at that time was writing the President describing the status of things he said this, he said "I must note that in my travels through the State I have seen little support for the concept of equity participation in the line because Alaska's citizens believe that the project is strong enough it will be able to attract equity in private capital markets. So putting all that together we just haven't pursued that.

Fahrenkamp: Are there other questions. Thank you very much Mr. MacKay.

MacKay: Thank you.

Fahrenkamp: Cecil Chapman, Engineering Services Manager for Alaska, Atlantic Richfield Company.

Chapman: Madame Chairman, my name is Cecil Chapman and I'm with Arco Alaska in Anchorage. Just by way of background I've been in Alaska since 1969 and have followed the development, initial

development ... startup in production and now forward planning for Prudhoe Bay fields. My purpose in being here today is to share with you a statement which has been prepared by the Prudhoe Bay working interest owners regarding the effect of delay gas sales on Prudhoe Bay performance and development. Copies of the statement have been furnished to you, it's a three page statement, I would like to paraphrase from the statement at this point. Prior to the field going on production in June 1977, a gas sales of 2 billion cubic feet per day were anticipated starting as early as 1982. All of the studies done by the major working interest owners indicate that the optimum operating plan for Prudhoe Bay includes early gas sales, and that the reservoir can be managed such that the gas offtake will have little or no effect on ultimate oil recovery. Considering that the Prudhoe Bay unit gas and associated liquids are approximately equivalent to one third of the total recoverable hydrocarbon reserves of the producing reservoir and that simultaneous oil and gas sales can allow lower economic production limits in abandonment, the unit owners certainly very strongly support early gas sales. With regards to reservoir performance and plans and the impact on these areas the performance of the Prudhoe Bay Sadlerochit Reservoir is and will be for some time dominated by the expansion of the large gas tap. Assuming that gas sales occur by early 87 production of gas will have increased to the point that the entire production volume to support 2 billion cubic feet per day of sales can be produced from the oil wells, and I might clarify that the with the expansion of the gas cap into the oil rim area we're seeing increases in gas/oil ratios and wells such that the producing oil wells will actually allow the production of the gas volumes that will be required in order to satisfy the gas pipeline demands.

The associated gas production that is produced in excess of the fuel and other consumption requirements is currently being re-injected into the gas cap by use of the central compressor plant and this will continue to be the case until the start of gas sales. Now with the startup of sales the field gas handling capacity will increase by approximately 500 million cubic feet of gas per day. The central compressor plant as it sits there today and incidentally, this past summer we just brought up a 13th compressor unit there which allows us to achieve an inlet volume to the gas compression plant facilities of approximately 2.1 to 2.2 billion cubic feet of gas per day. With the startup of sales we would add a field offtake of about 2.7 billion cubic feet per day and this is specified in the field rules for Prudhoe Bay units, and this would allow us to increase up to this additional level of 500 million cubic feet of gas per day. Now this increase is significant in that it does allow an increase in oil production from high ratio wells and initially this increase in oil production would be something on the order of a hundred thousand barrels of oil per day. Now the benefit will erode of course with further increases in gas production, but expansion of the gas handling capacity will allow us to provide incremental oil production for some period of time. A delay in the commencement of gas sales is not really expected to have a significant effect on the ultimate recovery of Prudhoe Bay. In previous public testimony the unit working interest owners have stated that delay in gas sales until substantially all of the oil has been recovered could increase the oil recovery approximately one percent of the original oil in

place. Less drastic delays on the order of say one to three years will have an even smaller effect. Also gas sales timing impacts on oil recovery are tempered by the initiation of a major water flood in 1984 to which the unit owners are already committed and this project is very much on schedule at this point.

With regard to operating in facility impacts significant delays in gas sales can have a major effect on field facility and operational requirements. In the absence of gas sales in the 1987 timeframe additional facilities would be necessary to provide the equivalent field gas handling capacity again due these increased gas/oil ratios if we're to maintain the production of - these additional facilities and these would be compressors and lines and additional wells and so on, would result in extra capital operating and maintenance costs of about 150 to 200 million dollars for the producers. More importantly continued injection of gas back into the gas cap consumes more forms of energy, each year the gas sales are delayed would require approximately 30 billion cubic feet of fuel gas or the energy equivalent of over 5 million barrels of oil.

By way of summary the objective of the Prudhoe Bay field producers is to achieve the maximum economic recovery of oil, gas and gas liquids. Studies have shown that with sound reservoir management which includes this very large commitment to water flood in 1984 all of the interests in the field can be best served by simultaneous production of oil and gas. This can be achieved by early gas production through facilities installed for oil production and a long term by prolonging the oil production while gas production operations continue to be viable. These combined effects can be maximized by the early realization of gas sales. Delays in gas sales carry penalties associated with the fuel consumed in re-injecting the gas which cannot be sold and with the potential burden to provide extra gas handling facilities to sustain oil production at economically optimum rates.

I guess by way of summary the feeling and certainly the conclusion of the producers is that we very definitely support early gas sales and appreciate very much the interest that this committee has and we appreciate all the support too. I think it was stated in the outset that I would also be speaking to financing, that had not been part of my plan today, so at this point I tender myself for questions.

Fahrenkamp: Very well, are there questions from members of the committee.

Q.: So your point is, you favor construction of the gasline, you don't think it's going to hurt your oil production, is that your point?

Chapman: Yes sir, that is correct.

Q.: Thank you.

Q.: Madame Chairman, if I could?

Fahrenkamp: Senator ...

Q.: In the prepared text, I'm assuming that this was what you were reading from?

Chapman: Yes sir.

Q.: There are several references in here, the gas liquids, and gas, and in your summary, oil/gas and gas liquids, and of course we've all heard the studies about the gas liquids through the Dow-Shell Study, and the producers were a major part of that study, and because of the reference in here, has there been some decision reached in the design of the facility where there would be a ... attempt to separate gas liquids as this financing goes forward in the line?

Chapman: As part of the gas conditioning facilities for the pipeline?

Q.: Yes, in other words the gas conditioning facility now is part of the pipeline, and what, I guess what I'm saying is, what's the status, is that gas conditioning facility going to be set up so that gas liquids can be extracted at Prudhoe Bay, Fairbanks, or has that decision been reached, and maybe I'm even asking the wrong guy, I don't know.

Chapman: Yes sir, I think I would really rather refer that question to Mr. MacKay, he can probably speak more effectively to that particular aspect of ...

Fahrenkamp: Are there further questions?

Q.: Madame Chairman, with your indulgence I would like to ask that question of Mr. MacKay.

MacKay: I'm sorry, could you repeat that, I couldn't quite hear all of it, in back,

Q.: In the producer's statement here, they make references to not only oil and gas, but gas liquids, and my specific question is, has there been or is there an attempt to be a design of the conditioning plant, so the gas liquids may be extracted at Prudhoe Bay, or Fairbanks, or has it been addressed yet?

MacKay: ... (gap on transcription) additional material out of the gas stream, but the initial design of the plant to extract what's necessary to make the gas transportable through the pipeline.

Q.: Through the pipeline?

MacKay: Right.

Q.: Okay, what happens to the rest of it, because obviously not all the gas liquids can be transported down the pipe, is that re-injected under the scheme now?

MacKay: The present design in, and I might say that all of the contractual arrangements surrounding this situation has yet been put in place as between the producers, the shippers, and the plant itself, but

the design contemplates that some of the liquids would be blended with the fuel gas stream that's used on the North Slope, some of the liquids would be transported or blended with the oil and go through the oil pipeline.

Fahrenkamp: Representative Bettisworth.

_____(?): I'm through for a second, I want to think about that last one.

Bettisworth: Okay, thank you Madame Chairman, in regards to the gas liquids, as a percentage of the gas liquids in the gas that will be extracted, what percent's going to go down the pipeline? If your gas volume runs 16-18% gas liquids, how much of that, those liquids are going to go into the gas stream, or go down the pipeline?

MacKay: Oh, I'm sorry I can't answer that question. I don't have in mind the, how that is, how those volumes are shared.

Bettisworth: If I may pursue this just a, just a touch, Madame Chairman. Most Alaskans and myself included are particularly interested in the gas liquids because of the value added possibilities, even for just minor manufacture, and the gasoline that's going into the States is a dry gasoline so those liquids are going to come out somewhere, and apparently they are going to come out somewhere in Alberta, and they're gonna be should be in such volume that the large percentage goes down the pipeline to create a substantial petro-chemical industry, and recognizing that they all, there is an existing industry in Alberta that could probably handle it, Alaskans would very much like to have something like that up here, and that's going to I'm sure be weighing heavily in the minds of those legislators who are looking at any possibility of help in the financing field as to what happens to those liquids, and I for one feel quite strongly that way and I think there probably are others.

Fahrenkamp: Representative Bettisworth, I'm sorry that we did not in our invitations to them or in any way prepare them for the questions that they're getting now, (babble), are there further questions?

MacKay: Just one quick comment, there will be no liquids extracted in Canada, I can assure you that. This will be a separate system and the contractual arrangements and the tariff arrangements will assure that that does not happen. It is contemplated that what would happen is that the gas, the heating value that's present will be sold in the form that is delivered.

Q.: Madame Chairman, if I may?

Fahrenkamp: Representative Ray (?)

Ray: Recognize that the gas liquids increase in BTU value, cubic foot gas considerably, your suggestion that is not going to be then dry gas exported from Canada into the lower 48, that it will have a liquid gas mixture in it that will increase the BTU's?

MacKay: No, technically it's difficult to directly address what you're getting at, if the stream can be gaseous or vapor and still have hydrocarbons in it that could be liquified, for example the component that's most valuable for petro-chemical development is ethylene, in order to make ethylene, well that's a very common part of natural gas stream delivered every day in the lower 48, and it doesn't take a liquid form unless it's specifically extracted and used as a separate product, so I think the answer is yes, the material stays in a gaseous form, it's still dry gas in that sense, it's not in liquid form as it's delivered to the consumers in the United States. Does that help somewhat?

Ray: To a degree. Okay if I may just one more and then I'll be quiet. I wouldn't expect that you'd probably answer this right now, but somewhere hopefully in the very near future somebody will answer it, but it's been rumored and I will concede that at this point it is strictly a rumor and there's lots of talk and hearsay about what's going to happen to this fabulous gasline, that liquid rich gas from Alaska which is supposedly a lot higher BTU content will be traded for dry gas in Canada for a largely increased volume, in other words a cubic foot of rich gas for less rich gas to expand the volume that will be exported to States for sale.

MacKay: I can tell you that there is no substance to that at all with one very minor exception, and that is that we do expect to work out some arrangement with the Canadians to provide gas service to some small communities in the Yukon and that not now receive service, but it would not be for the purpose of liquid extraction, volume is very small so that would be the only exchange of ... ever been discussed, and I'm sure I would know about any such discussions as that heat content of gas is a very critical thing to shippers (garble)

Q.: Very good, thank you.

MacKay: Right.

Fahrenkamp: Thank you very much, are there further questions of Mr. Chapman? Thank you very much for participating, we appreciate it. Ken Showalter from Sohio.

Showalter: Thank you, Madame Chairman. I'm Ken Showalter, Director of State Government Affairs for Sohio, and the previous witnesses have pretty well covered the subjects at hand and most of what I might have said was covered in more detail and probably with more expertise than I could have done, and I'm sure that Kidder Peabody panel will do the same on the financing issue from their perspective, so I'll keep it very short and try to respond to any questions you might have and help you along on your 4:30 schedule.

I do want to emphasize that Sohio is seriously pursuing this project and that's evidenced by an expenditure by our company to date of some 40 million dollars in studies for the project and we've been active in the various negotiations and hearings in various forms regarding the project. A lot of hard work has been done by a lot of people and is ongoing to make the project a reality. We intend to pursue those

efforts to an ultimate conclusion which we hope is the completion of this transportation system that will allow us to sell the sizeable volumes of gas reserves that we have at Prudhoe Bay. Whether or not the State participates in the project obviously is a question that can only be answered by this body, the legislature. Sohio can't answer that question for you. We recognize that the State must follow this very important matter in the manner that they're doing and we would only counsel that if you come to the conclusion that it is a prudent thing for the State to participate in one manner or another that it be done in a pure investment sense comparing it with other investments that you might have and comparing the benefits and the costs of all of those projects. Beyond that I don't have a lot to say, our invitation included the same question that Mr. Chapman responded to, Sohio is fully in accord with the position that he laid out, our engineers participated in working up that response some time ago and all of the unit owners are in fact in agreement with that statement. With that I'll try to respond to any questions, I'm not a finance man nor a petroleum engineer, but I'll try to respond.

Fahrenkamp: Thank you, Ken, are there questions from members of the committee?

Cotton: Madame Chairman, I think that he answered my questions by saying that he had the same position that the other producers had, so that answers the question I might have had.

Fahrenkamp: Thank you Representative Cotton. I would like to invite the full team of Kidder Peabody at this time, that will be Ken Seplow, Joseph Schell, Otto Lowell, Roger Powell, as you speak identify yourselves for the record, and welcome to Juneau.

Q.: Madame Chairman, suppose we take five?

Fahrenkamp: Five minutes, yeah. We're ready and in good shape.

Co-chairman: As the House Co-chairman I'll call the meeting back to order. Senator Fahrenkamp had to go and take care of another matter, hopefully she'll be back in a few minutes. If you would go ahead with your presentation.

Joe Schell: Thank you Mr. Co-chairman, and members of the Joint House/Senate Committee on Oil and Gas Resources. I am Joe Schell, I'm Director of Kidder Peabody and Director of our Alternative Energy Group within our Corporate Finance Department. With me today are Ken Seplow to my right who is the Vice President of Kidder Peabody and Co-director of our Project Finance Group, and Otto Lowell, also a Vice President of Kidder Peabody whose enviable job is to look after our business in Alaska. One of the other members of our team who is in Alaska today but has left Juneau for Anchorage is Roger Pyle (?) who is the Vice President of our Municipal Finance Group and also a member of our Task Force dealing with our assignment for the State of Alaska.

First of all we thank you for the opportunity to come today and present you with our preliminary findings and I stress the word preliminary from the analysis that we have been doing over the last 45 days since we received the assignment for the State. As Commissioner Katz mentioned our assignment has been primarily focused on two questions. One, should Alaska participate in the financing plan for the Alaska Natural Gas Transportation System, and if the answer to that question is yes, then how should they participate. What is the most appropriate form for the State of Alaska to participate, given its other interests.

To date Kidder Peabody has been, my associates and I have been very active in holding meetings, reading all the various information that has been available on the pipeline and its progress to date. To give you an idea of what has been accomplished, we have had 4-5 meetings with the sponsors to discuss such things as their financing plan, the status thereof, the cost estimate and when that might be relooked at, the marketability of gas, their financial model which shows the returns available to the various equity sponsors of the project if everything goes according to plan, and also had discussions with their offices in Washington concerning the schedule for the FERC proceedings which will be upcoming later this year.

We have also met with the design engineers, being Fluor and Parsons, Fluor on the pipeline and Parsons on the Gas Conditioning Plant to discuss in greater detail the cost estimate to assure ourselves that the cost estimate procedures were realistic, based on our knowledge of how you go about that, and in determining how much sensitivity there is to the number which Mr. (?) ... out for the cost of the Alaskan portion of the pipeline. We have also and most importantly, had constant interaction over the last month and a half with other members of the task force from Commissioner Katz's office and Commissioner Williams' office particularly.

Our preliminary conclusions are as follows: First, our belief, based on our analysis to date is that the Alaskan Natural Gas Transportation System is the most viable alternative available to deliver Prudhoe Bay gas to the lower 48 within this decade. That there really are no other alternatives available, and it by itself is a viable alternative. We do not see any significant technical problems in building the pipeline. We believe the cost estimate procedures which have been followed and the cost estimate which has resulted appears reasonable at this time given the amount of engineering which has been accomplished, and although we are less certain of this conclusion it appears to us that the gas is marketable in the lower 48 states, that there may be a requirement to pursue such items as levelized tariffs to accomplish that fully.

We have been struck with the fact that all parties are working on the financing plan are doing just that, they're working very diligently to put together the financing plan. When we first received the assignment we were very hopeful that we could talk to the sponsors in our first meeting and have a full financing plan laid out before us. I think we became more understanding of the difficulty of that and you should be aware of that, that with ten project sponsors pipeline companies as project sponsors and three producer companies, it is a very difficult

task to get thirteen people to agree to anything. A financing plan is a very difficult procedure as was explained earlier by Mr. MacKay, the bank reaction to their first plan has altered their approach that they have taken, the project debt was not appropriate for the project, that the need for credit support to be provided by both the producers and the sponsors, that increases to a great extent the potential liability and potential investment of the various participants and it takes a great deal of time for them to come to an understanding internally within each company and agree among all thirteen companies as to how they want to proceed. That is one of the reasons I think it's taken as long as it appears to have to put together a financing plan, but it's very clear to us that everyone has diligently worked and could do that.

The third item among our preliminary conclusions are the following that we believe that the transportation system has definite net benefits to the State. Measuring those benefits is a difficult procedure and is not part of our assignment at this point, but from the work that we have studied on the national net benefits analysis which had been done before and some of the state net benefits analysis which is ongoing right now, we believe they're very significant benefits to the State in seeing that the Alaskan Natural Gas Transportation System becomes a reality.

The sponsors and producers in the ultimate financing plan when it does come to the forefront will be committing huge amounts of their capital, both on an absolute basis, talking about numbers that are in the 20 billion dollar range, 20 to 30 billion dollar range for the total pipeline system, most of that both in the form of equity and credit supported debt will come from the sponsors and producers. So the absolute amount is huge, the relative amount of financing that they would be responsible for relative to their existing businesses, their existing asset base, is also very, very large. However, it is also apparent to us that with those huge commitments made by those thirteen companies in their pro-rata share there may be and most likely be a need for additional financing beyond that as was mentioned earlier by Mr. MacKay, a portion of that financing may be accomplished on the basis of the project itself, provided that financing is put in towards the end of the project, and the issue which we will be addressing shortly, the State may have a role to play in filling that financing gap over and above the significant commitments made by the sponsors and the producers.

We feel that support for a financing plan by the State of Alaska at this early point can only serve to enhance the probability that the transportation system will go forward and become a reality. That that form of support not only the dollar amount, but the statement of an expression of interest in seeing that this becomes a reality, is very important to the pipeline's success at this point in time.

And lastly, we believe that Alaska can support the financing plan with very minimal risk on the part of the State, and my associate Ken Seplow will discuss our preliminary thoughts along these lines and we will be obviously available to answer any of your questions as they come up. I would again stress that what we are trying to do today is verbalize what we will be putting in writing shortly at the direction of

the task force so in the next three or four weeks trying to give you a sense of where we are today in our analysis of what options the State has available to it.

Seplow: In the course of our analysis we've looked at a number of different alternative modes of investment or involvement in the pipeline financing plan on the part of the State of Alaska, most particularly, we have looked at the possibility of Alaska providing equity to the project, and our tentative view although I would stress that I see little on the horizon to change that view, would be that equity would be an inappropriate vehicle for Alaska in terms of this project, and there are quite a number of reasons for that. When you assess the appropriateness of investment, one of the first things you have to do is evaluate the capacity of the investor to bear risk, then you have to evaluate risk and see whether or not the investor can stand the loss that would result if things don't work out. Now in these terms I think we have to acknowledge that an equity investment is the riskiest part of this project and given the posture of Alaska as a State, and given our understanding of Alaska's financial resources and future prospects, Alaska, we think, would find it very difficult to bear that risk, and it would seem to us to be inappropriate to ask Alaska to bear that risk. Another element of inappropriateness about equity investment is that equity investment has to be made up front. Indeed the financing plan that has been advanced that may even be required by the terms of the Presidential Decision requires that the anticipated equity funds be invested in the project before any debt funds are invested which would require of an equity investor that it have available the cash to put in almost immediately, and as we review the financial position of the State and its projections for the next several years and the other calls upon its resources, that various members of the State Government have in mind and have perhaps even tentatively committed the State to, there just doesn't seem to be any cash up front for that equity investment. Now even if Alaska were to make an equity investment there's some serious question as to whether this would be the most appropriate investment in terms of the kind of return that Alaska could get. After all, investment in this pipeline conditioning plant is investment in a regulated enterprise and as such the upside return potential is distinctly limited indeed over a fine-eyed (?) period of time as that investment is amortized the actual cash flow return declines. In addition to that we carefully analyzed the projected return to the system owners and we find that a major portion of the return appears in the tax benefits that accrue to those owners, and those are tax benefits which Alaska as a public body cannot share, and indeed the presence of Alaska as an equity owner were the owner of a segment of the transportation system might in fact fritter away tax benefits, several tax benefits that would otherwise be usefully employed in attracting capital. In addition, of course, we heard Mr. MacKay say today that apparently the sponsors have lined up the equity, they don't need Alaskan equity, there are concerns that have been expressed not only by Northwest, but people within State Government about the appropriateness of Alaska being both the regulator and taxpayer of this system, and an equity investor in the system.

All in it just does not seem that there are sufficient real benefits associated with an equity investment and there seem to be quite a number of drawbacks to an equity investment so we have as I said tentatively but probably approaching conclusively, we see a conclusion that would recommend against any consideration of equity investment. I might just make one footnote on this equity investment concept. A number of people have suggested that Alaska should own a segment of the system, for example, the conditioning plant. I've heard it frequently said here that Alaska should own the conditioning plant and I think that presupposes that ownership of a segment such as the conditioning plant would vest Alaska with some degree of control over that facility. I think that that's a misleading notion because I do not think that the other parties to this project, either the producers or the sponsor, the pipeline companies or the banks that will be supplying funds are prepared to see an independent party operate a segment of the plant in a way that is not consistent with the overall purpose of the plant, of the entire system, and indeed that was the theory underlying the whole waiver provision with respect to including the conditioning plant in the transportation system. The need to join the conditioning plant to the pipeline in order to create a satisfactory financing, so I think the illusion that there would be some opportunity to exercise control through ownership is one that probably should be dispelled.

Now, another consideration that we gave to another mode of financing on the part of Alaska that we considered was the possibility of Alaska providing it. And this is certainly a more acceptable approach in our view to equity, but still comes up with a number of drawbacks. The principal drawback is that again debt financing has to be funded early on some of the same considerations that I mentioned before about funding equity and the problems of finding room within the State's current and future budgets as projected particularly in light of expenditures which may be enacted by the voters really make it very difficult to find a place where the State is going to come up with the cash to fund debt in the next several years when the debt would have to be funded in order to provide a source of funds for construction.

Another consideration about debt financing is as has been alluded to earlier. The completion risk can be covered by credit-worthy parties. World capital markets appear to be adequate to meet the debt financing needs of the project, so in terms of making a contribution to the project coming together and getting done, Alaska's participation while it might be useful is not a terribly critical thing in order to ease that probability of ANGSTS becoming a reality. What really to be needed and which also seems to fit in best with Alaska's ability and risk-bearing position, would be to call upon Alaska to provide some of that contingent commitment supporting completion of the pipeline, supporting the debt funds that would be contributed towards construction. As has previously been discussed when Alaska last summer looked at the project they said that they would like to see credit-worthy parties backing up the debt that they supply with funds to construction and completion issue, we've already heard that producers and sponsors are making determinations, to some

extent have made determinations as to the amount of credit they can provide to support that completion problem, there are some questions as to whether or not the producers and sponsors collectively will be able to pool enough credit to meet the bank's requirements, there is a risk that the project may fall short in that respect there is a possibility of a so-called gap in terms of that credit support and we think that the most critical need on the part of the project in terms of this financing plan is to fill that gap and Alaska seems to be particularly well suited to do that if Alaska is to do anything. Although the completion risk is the most risky part of the project perhaps there are ways in which to minimize that completion risk with respect to any particular party backstopping that risk, and a principal way of doing that is to what we call backload the responsibility, and essentially what that means is, that any funds that any commitments Alaska would make which would be designed to support the infusion of debt into the project, would be invested at a later stage of construction, toward the back end of construction at a point in time when it would be far easier than it is now to assess the problems that may have arisen that may arise in the course of construction and to assess what funds are necessary to achieve completion, and if the debt funds that Alaska backstops, investment of those funds are conditioned upon, assurances that those funds plus other funds that are available, are sufficient to provide completion, that risk is very significantly reduced. Now one of the other important benefits of this approach is that this approach requires a minimal up front cash commitment by Alaska, and consequently it provides a minimal interference with the State's other investment and expenditure plans. To give you an example of how this might work, if Alaska backed up, provided a back up to debt funds which were only required to be invested after the equity in the project had been expended, and after a debt funds backed up by the producers and sponsors, the funds that Alaska would be backing up would probably not be called upon until fiscal year 1985, at a point in time when a projected three-quarters of the cost of construction would have been expended, and as I indicated before, Alaska-backed funds would then be invested only after receipt of assurances that sufficient funds were provided by the system owners to complete and that the gas would be marketable. Of course once completion has been accomplished the State would have no further liability on its credit backup. Now we've been assured that if Alaska entertained this type of commitment that Alaska would receive a market rate type of compensation for its commitment and that presumably that compensation could either be paid in a lump sum or over a period of time, it presumably could be negotiated either in a fixed amount or in a variable amount depending on the inflation rate in the future, or could it could be pegged to the equity earnings of the sponsors in the project. There are a great number of alternatives as to how that could be designed.

Fundamentally, as we have indicated, we think that this approach does the most for getting the project done, and yet places a minimal risk on Alaska and a minimal call on its current funds. There has been some discussion and Commissioner Katz testified earlier about the approach that Alaska ought to take at this time. We recognize that the details of the sponsors' financial plan will not be available until probably the spring of this year which is really out of sync with the consideration

that this legislative session can address that plan. Now the State could wait until the sponsors develop all of the details of the plan but in view of the fact that the legislature will be going out of session the State will not really be in a very effective position to deal with that after it goes out of session. Consequently we would suggest that if something positive is to be done that there be some sort of expression of support in general for the concept that we are recommending enacted by the legislature or otherwise developed by the legislature and the executive body of the State, and this would perhaps be in a form of a resolution expressing general support for this concept attaching conditions to Alaska's participation and such conditions might include satisfactory assessment by Alaska of all of the risks including the cost and completion risks, and marketability as well as the satisfactory structuring of the commitment to minimize the specific risk on Alaska's part, number two, assurance that an adequate compensation of the, provided for Alaska for undertaking these risks, number three, that there be adequate assurances associated with the problem of Alaska's interest in the wellhead value of the gas. Another condition might be an adequate resolution from the State's point of view of the issue of compensation to the State for the socioeconomic costs of the project, certainly a condition would be that all of the other elements of the financing plan including commitments from other responsible sources be provided. Now this approach would, as my colleague has said, by expressing the support of the State for the project and giving some tangible evidence of that support and being prepared, evidencing the State's willingness to sit down and negotiate details of this participation, would certainly enhance the chances of the project coming together and the other financial participants coming forward with the necessary commitments. It certainly would indicate that this project has a very welcome environment here in the State of Alaska and it certainly indicates that things would be, would be further evidence that things are falling in place in terms of the consummation of this plan.

Moreover, by taking this step I think Alaska would really be gaining a seat at the negotiating table concerning the financing. I mean Alaska's involved in that but in a sense as a partial outsider, and by stepping up and saying we're interested in participating Alaska would gain an opportunity to sit down with all of the other serious participants in the financing plan and have a say about all of the elements in the financing plan, including those elements associated with marketability, whatever arrangements are made with respect to levelizing and that would be an important means by which Alaska could protect its interest in the wellhead value.

Now I want to conclude by saying that the remarks we've made are still tentative, and we've got to sit down and digest some additional information that we've gathered during our visit to Juneau, we've got to put this all on paper for consideration of the task force and public, we are still a little general in some of the concepts that we're talking about, specifically some of the legal elements associated with the implementation of this suggestion have yet to be worked out in detail, but work is continuing and this is a very high order of priority personally and on the part of our firm, and we hope to be back up

here in a couple weeks with our written report and to again submit ourselves to detailed questioning concerning our recommendations.

Q. Thank you. Any questions to same?

Q. Are you ... (garble) and I do have some questions. Let me see if I can ... see if I can just summarize this in layman's terms, what you're saying to us is that the examined equity debt, some kind of contingency ... and that you feel that equity is inappropriate because of the three or four reasons that you set aside, the debt might be more appropriate that it's really not critical in terms of the entire financing, if that's all we're going to get involved with because of the posture of the worldwide price of ... for the financing, and so you're asking us, I say you're asking us, the idea is for us to consider contingency commitments, something that's at the tail end, we probably wouldn't know what that would be until halfway, ... or later, I'm assuming when you say halfways (?) five year, still using 1986 schedule that Northwest has at this time, so could and probably would be later than 1985, fiscal year 1985, is that correct?

Seplow: That's correct.

Q. So we really wouldn't know the dollar amounts that we might be asked to consider until that time. Is that correct?

Seplow: No, perhaps I didn't make that clear. We would be talking about Alaska either currently or within the next year, making a firm commitment to support a credit debt up to a maximum dollar amount, what you wouldn't know about until 1985, 1986, or conceivably 1987, is whether that commitment will be called upon,

Q.: Or even if it's enough?

Seplow: Well, if it isn't enough, and if at the time that commitment, the debt funds which that commitment is backing up, is apparently not enough then the debt funds would not have to be invested, Alaska would be taken off the hook until the sponsors and producers could come up with additional funds that would assure that all those funds together would be sufficient to complete.

Cotton: That's about the same question I had on the completion guarantee--I wanted to know if there was a specific amount that we have to lay out here and by tying it to whether or not the producers or others could come up with whatever the additional required funds were, that would significantly lower the risk to the State as far as its participation, is that correct?

Seplow: That's right.

Cotton: That's sort of the idea, and let me make sure I understood the marching orders that ... (gap)

Seplow (?): we think was referred to earlier includes more than those assets,

Cotton: So they would have to make the same assumptions about whichever portion of the project that you were talking about, wouldn't you?

Seplow: That's true.

Seplow: And that the Canadian sections is another part of it, and the prebill, that the part we have focused on because of our assignment for the State is the Alaskan segment not all the rest of it.

Cotton: Okay, I didn't mean to get lost, go ahead.

Seplow: There's one other point that I'd like to make, and that is, if the State were to adopt the approach that we've suggested, which is that it provide a contingent credit backup, the State would not be putting any funds out so the State would not be earning any funds, a interest rate, because the funds are not invested. What the State would be getting is some sort of compensation for having assumed that risk, and that would obviously be largely a function of the assessment of that risk, and it might be impacted by what overall interest rates were.

Cotton: ... once they finally made the call on these funds if in fact they made a call on them, .. point of guaranteeing that they'll be there is because they need them, right?

Seplow: Right.

Cotton: If they didn't need them that would become part of the debt?

Seplow: It's not there in case they need them, it's there to, those funds are going to be put up by perhaps the same group buying some insurance companies that are going to put up the funds that are guaranteed by the credits of the producers and the pipeline companies, it's just going to have a different credit, it's going to have the State's credit instead of Northwest Energy's credit. If the pipeline for some reason is not completed then the providers of the debt capital are not paid their interest and principal repayments on time, then they will call their obligations, they will come to the State of Alaska and say you owe us X dollars depending on the strategy ... (garble) will go to the producers and the pipeline companies ... saying call that they have because they guaranteed the securities so there will be no monies put out by the State of Alaska other than those funds which they might segregate to support their guarantee if it ever got called, whether you have to put up dollar for dollar that amount, make some provision that you put up some monies in overtime that's invested such that gets the guarantees called in some future point in time there'll be enough there to pay the guarantee off. There are all kinds of mechanisms which we haven't worked out yet to support the guarantee.

Cotton: Okay, I was wondering, let me get back out here and let somebody else have some questions. I want to make sure you understand that our, I understand what your position is, you're working for the State and we're paying you to give us advice so I'm

not trying to interrogate you I'm trying to understand, there's a lot of new things here that I'm not that familiar with. I assume you don't also represent any of the pipeline companies or the gas producers, is that correct?

Seplow: Right. Unfortunately that's correct.

(Much laughter).

Cottor: Thank you.

Q.: Following that one step further because I think Representative Cotton opened up something that I was interested in, you mentioned that the State's guarantee comes on last, the question is, if you get a call of obligations, is that call also satisfied last, in other words, if you're talking so many billion dollars that are supported by the pipeline companies as well as the producers and you finally get down to the State's call, is that negotiated to be or recommended to be also the last call in that order as well?

Seplow: It probably would work out so that the call occurs simultaneously, there's probably an outside date by which the project is supposed to be completed, and that date may very well tie in with the FERC set date for when the prebill period commences, and there would be institutions who would be looking to be repaid the debt that they have provided to the project, by that date if it hasn't been completed by that date, and some of those institutions would be looking to Alaska and some of them would be looking to Exxon, some of them to Sohio, some of them to Arco, and some to the pipeline companies, but that would all happen probably simultaneously, now if the project is not completed and we're talking about worst case, by that outside date then each of the credit supported parties would have to step up and pay off that debt, and they would in effect be purchasing that debt and so Alaska would step into the shoes of some of the senior lenders who have a first lien on the project, and they would be Alaska's interest but at that point in time would be senior in claim to the pipeline, to the equity that the sponsors and producing companies have put in, and at that point in time, Alaska and the other holders of the debt would have to worry about what it would take to get the pipeline completed and where those sponsors going to come from, and in the first place, they probably look to the producers and sponsors who have all that equity invested to see if they could provide additional funds. They would have a very powerful motivation for doing that but they wouldn't be legally obliged to do that, now if for some reason they felt that the project had receded in economic viability to the point that they didn't want to put any more money in underneath the first lienholders, then the holders of that debt would have to worry about attracting senior debt, that giving up some of their senior position in order to get enough funds in to complete the project, and you have to go through a rather horrendous litany of events whereby Alaska ended up not only losing some of its money or it really have to go to extremes to come up with a conjured up case whereby Alaska lost all of its money, but Alaska would fill the gap that in terms of taking that kind of credit risk which apparently the banks at this juncture are not prepared to

take except for very small portion of the funds, and I think that the view is that Alaska would probably take, that the banks may take the last few dollars' risk if Alaska would take the dollars before the banks. So basically, before Alaska does anything the project's sponsors and the producers are on the line for three-fourths of the total, again before the State of Alaska loses anything the sponsors and producers have already lost all of their equity share. They've lost the equity share and they've come in for a debt share representing let's say half of the cost of the project, which may equally on one with Alaska. The benefit of that approach is that it maximizes private sector participation prior to public sector participation, it is intended to be a private project as Mr. MacKay mentioned, that's the way they want to approach it and this plan fits very nicely with their desire to keep it a private project.

Q.: Representative Cotton.

Cotton: The question I get asked is ... why don't we build an all Alaskan gasline. I know that every bit of advice we've ever got said that it is not feasible and you've made a statement similar to that that suggests that the existing Northwest design is the most and probably the only viable system for this decade. Is that included in a report some place, I usually say that too, but I want to be able to prove it I guess.

Seplow: Can I, maybe we shouldn't be as categorical as we've been making that statement but frankly, the concept of an all Alaskan line is very appealing to me six year ago but a lot of water is gone over the dam in six years. We've had at least three significant problems arisen that may get virtualy impossible to conceive of an All Alaskan pipeline in this decade. First of all you've had El Paso which was the sponsor of that project withdraw from the LNG business with terrible financial bruises, they have written off something like half of the corporate equity as a result of losses that they have sustained in the LNG business, and maybe those losses have nothing to do with the kind of risk that they would be exposed to in Alaska, but basically they are out of business in LNG now. Second of all, you've had an inability to get a regasification facility site on the West Coast of United States, they've been working on that for probably ten years, or a good part of ten years and it still hasn't come to fruition, and thirdly, one of the great attractions of the El Paso LNG project was that you could use Title XI US Government shift financing bonds to back up a lot of the credit, well that program has been deminished as a result of the Reagan Administration fiscal constraints and as a result of some poor experiences that the Maritime Administration has had with LNG in other projects, they are not about to give any of their now very scarce guarantee authority to an LNG project of this order of magnitude, so I just cannot see how a project can come to ... even apart from a long lead time that any such project has.

Cotton: So in addition to other things that Ronald Reagan, is because of ... has not been able to consider that all Alaska line.

Seplow: That's only one of three causes.

Cotton: Thank you.

Q.: Are we going to turn this into a partisan discussion?

Cotton: Sure.

Q. Any further questions.

Q.: Mr. Chairman, just so that I understand about three hours ago I think, I think it was pointed out that you would be back in March?

Seplow: Yes, when we complete our report we will submit it in writing and then at the convenience of the committee and legislature, we'll be back up to discuss it.

Q.: Thank you.

Fahrenkamp: I would just like to thank the gentlemen, I know it was a little time-consuming on your part ... to give an interim report before you felt you were ready to go with that, and we really appreciate your taking the time to do it.

Q. Just one last shot I don't know if it was asked while I had to break for another meeting, to what extent have you gone into deregulation of natural gas as far as it affects marketability?

Seplow: We certainly looked at the question and I want to emphasize that we are not the ultimate authority on marketability. We have read the Jensen Associates report that Northwest submitted and we've looked at a number of other sources on that issue and we think it has an impact on marketability. However you slice it you can make a good case for marketability, but you can't make an absolutely conclusive case for marketability without some mechanism which backend loads the gas, the transportation and or wellhead cost. It would appear to us that that is a very critical element in terms of assuring the marketability of the gas and one of the advantages of the approach that we've taken as I indicated earlier is that by Alaska stepping up to, as a negotiator about the financing plan, Alaska would have an opportunity to have a first hand impact on those arrangements.

Q.: That will be part of your final report?

Seplow: Yes.

Q.: Just as you went by that you said backend loads the transportation and the wellhead cost, of course when I think of the wellhead costs I think of the wellhead costs of the State's share as well, and backend loading there and what the effect might be I just, I'd like to hear more about that and get the,

Seplow: Well, I mean, certainly the wellhead could possibly be backend loaded and that might not be a disadvantageous thing for Alaska and for the producers provided that they were compensated for the ... of both in terms of the time value of the money they are foregoing and in

terms of additional risk that they are incurring by waiting longer for the payment.

Q.: Thank you.

END.

Alaska Oil and Gas Association



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(907) 272-1481

February 12, 1982

Senator Bettye Fahrenkamp
Chairman, Committee on Resources
Pouch V
State Capitol
Juneau, Alaska 99811

Dear Senator Fahrenkamp:

Thank you for your invitation to share with the Resources Committee AOGA's comments on the State's 5-year leasing program.

We will contact your staff as soon as possible regarding scheduling an appearance for the February 26 meeting of your committee.

Your interest in our industry's view is very much appreciated.

Sincerely,

A handwritten signature in black ink, appearing to read 'William W. Hopkins', is written over the typed name.

WILLIAM W. HOPKINS
Executive Director

WWH:mk

Alaska State Legislature

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Senate

Committee on Resources

A joint Senate-House interim status report on the Northwest Alaska pipeline project will be held February 17, Senator Bettye Fahrenkamp and Representative Rick Halford announced today. Fahrenkamp, chairman of the Senate Resources Committee, and Halford, co-chairman of the Special Joint Committee on Gas Pipeline Financing, are the legislative members of the Governor's Task Force on Gas Pipeline Financing.

"The purpose of the oversight hearing is to disseminate the most up-to-date facts regarding the state's interest in the gas pipeline financing to the public and the Legislature. Since passage of the waiver package in Congress last December, there has been very little information exchanged in the Legislature which ultimately will have to approve any participation by the State," said Halford. He added that the Task Force will focus on three major questions: "Should the State participate in the project? If so, how and to what extent? And what are other prudent and competing uses of the State funds?"

Working with the two legislators are Natural Resources Commissioner John W. Katz, Revenue Commissioner Tom Williams, and Attorney General Wil Condon.

Earlier activities by the Task Force included an early December meeting with Northwest Alaska and its investment bankers, and the hiring of a national investment banking firm to assist the State in the financing evaluation. The firm has started to compute a risk analysis

model, as well as the evaluation of the relative risks and rewards to the State of any proposed investments in the project. Information is also being gathered from the nation's major investment banking institutions and the North Slope gas producers. An interdisciplinary staff group from the Departments of Natural Resources, Revenue, Law, Budget and Management, and the Legislature has undertaken in-house research on financing issues.

A preliminary report will be made on key issues to the Governor and the Legislature on March 1, said Fahrenkamp. Under scrutiny are the costs and benefits to Alaska of the Northwest project, in-state use of gas, Alaska's financing capability, Alaska's comparative investment opportunities, and the regulatory and tax implications of State participation in a private industry project. Also under examination are Prudhoe Bay gas marketability, impact of proposed gas deregulation, availability of investment capital, and the proposed financing structure of the Northwest project. "Although we may not reach a definitive answer within the time frame set out by the Task Force, we do hope to develop sufficient information to conclude whether to continue with a more indepth analysis regarding the State's interest in participation. This conclusion will partially be based upon the proposed financing package by Northwest, which is expected during the study span," said Fahrenkamp. "By some time in March we should be able to recommend to the people of Alaska, the Legislature and the Administration whether or not the state interest in participation in the project is feasible, cost beneficial and in the overall best interest to the State of Alaska."

Alaska State Legislature

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Senate

Committee on Resources

February 17, 1982
1:30 p.m.

Courtroom A

With the House Oil and Gas Committee

MEMBERS PRESENT

Senator Fahrenkamp
Senator Gilman
Senator Mulcahy

Representative Halford
Representative Bettisworth
Representative Cotten
Representative Rogers
Representative Randolph
Representative Bylsma

Interim Briefing on Financing of Alaska Natural Gas Transportation System

John Katz, Commissioner, Department of Natural Resources, said the State supports the waiver package, and has been advised that the current lawsuit won't prevail. The task force, which is looking at state participation in financing the line, marketability of Prudhoe Bay gas, and alternative investments available to the State, will report their initial findings and recommendations in early March.

Darrell McKay, Northwest Alaska Pipeline Company, reviewed 1981 accomplishments: completion of the Canada-to-California portion of the pipeline; passage of the waiver package; and inclusion of the conditioning plant in ANGTIS. Northwest is confident Alaska gas is marketable. Ten pipeline companies are committed to equity and debt financing. Foreign assistance will be needed. The producers and banks are working to determine terms of the financial package. Mr. McKay stated that he thinks the pipeline is a good investment for the State, and hopes the State will guarantee a share of the project debt. Completion goal is late 1986. Estimated cost (in 1980 dollars) is \$39-48 billion.

Cecil Chapman, Engineering Services Manager, Alaska ARCO, Inc. spoke for the Prudhoe Bay Field Owners. They support early gas sales, but think a delay in sales will have little effect on ultimate oil

recovery and no significant impact on ultimate gas recovery, except for the amount of gas used as fuel for re-injection purposes. Delays in sales will impact field facility and operational requirements. Interest in the Field can be best served by simultaneous production of oil and gas.

Ken Showalter, Director of State Government Affairs, SOHIO, said he is in accord with Mr. Chapman's statement.

Joe Schell, Alternative Energy Groups Director, Kidder-Peabody, said they had reached the following preliminary conclusions: ANGTS is the most viable alternative for delivering natural gas to the Lower '48 in this decade; the gas is marketable; ANGTS has definite net benefits to the State; State support will enhance the probability of ANGTS becoming a reality; and the State can support a financing plan with minimum risk.

Ken Seplow, Vice President, Kidder-Peabody, advised against both equity and debt investment. He urged the State to provide a contingent commitment supporting completion of the pipeline. Risk could be minimized by "backloading" (State funds could be invested near the end of the project), and the State would receive compensation for taking the risk. Seplow concluded by suggesting that the legislature express their general support through a resolution listing conditions of participation.

The meeting was adjourned at 4:20 p.m.



Alaska State Legislature

SENATE Resources Committee

Official Business

BETTYE FAHRENKAMP, Chairman
VIC FISCHER, Vice-Chairman
BRAD BRADLEY
DICK ELIASON
DON GILMAN
BOB MULCAHY
ARLISS STURGULEWSKI

March 31, 1982
1:35 p.m.

Senate Finance Room

POUCH V
STATE CAPITOL
JUNEAU, ALASKA 99811
(907) 465-3834
(907) 465-3835

With the House Oil and Gas Committee

PRESENT

Senator Fahrenkamp	Representative Halford
Senator Fischer	Representative Cotten
Senator Gilman	Representative Randolph
Senator Mulcahy	Representative Vaska
Senator Sturgulewski	
Senator Colletta	

Briefing on Financing of
Alaska Natural Gas Transportation System

John Katz, Commissioner, Department of Natural Resources, called Kidder, Peabody's report comprehensive and excellent, stating it was a sound, thorough analysis of the key issues. He explained that in the next 7-10 days the Task Force would formulate the results of the report into a series of recommendations to present to the governor and the legislature.

Ken Seplov, Vice President, Kidder, Peabody & Co., stated that the report concludes that ANGTS does have the potential to be financially viable, and is the only near-term means whereby Alaska can recognize the value of Prudhoe Bay gas. However, the marketability of Alaska gas continues to be a serious issue, and there is no definitive financing plan for ANGTS at this time. Kidder, Peabody recommends a \$3 billion, or 1/8 of project cost, State participation based on the following conditions: a minimal risk of loss, no significant appropriation of funds before 1988, and satisfactory mitigation of the risk of marketability. Seplov stressed that the State's participation would improve the chance of ANGTS being financed, and explained that the recommended \$3 billion investment would be debt financing, which is a low risk, low early funding approach. He advised against equity investment on the part of the State because of the high degree of risk it would entail, the limited investment return it would provide, and the policy conflict it would create with the State as both regulator and investor. He further suggested that the State's guarantee be limited to the construction period only, be a portion of the last \$7 billion to be spent, and be conditioned on the first \$20 billion having been spent

as scheduled without any cost overruns. The amount and form of the State's compensation would be negotiated, and could involve a lump sum or acquisition of an equity type security. Seplow concluded by saying that although the State cannot be expected to make a definitive action now, as it has not been given enough details and facts, the wheels can be set in motion through a legislative or administrative action showing the State's willingness to entertain the idea of financing, and authorizing negotiations to take place. There is need for action to be taken soon if the project is to stay on schedule, as long lead time must be allowed for purchase of equipment and the FERC permitting process must be entered into. This negates the opportunity for a vote of the people on State participation. Since a pledge of specific revenue would require approval of a majority of voters voting in a general election, Seplow suggested that the State should instead add its moral obligation to debt issued. There is already authorization for a moral obligation structure in the legislation creating the Alaska Gas Pipeline Financing Authority, although the legislation would have to be modified in some respects to be a useful vehicle for the negotiation and/or implementation of the State's financing participation.

Joe Donohue, Deputy Commissioner of Taxation, Department of Revenue, stated that all Kidder, Peabody's alternatives fall within constitutional perimeters and would be procedurally possible. The Department of Revenue is not prepared to make specific recommendations at this time, but does agree that the legislature should make a gesture this session if the State is willing to participate in the financing of ANGTS. There was some discussion of pledging a portion of the income from the Permanent Fund to secure debt; it was noted there may be Constitutional problems with this option.

Milt Barker, Fiscal Analyst, Legislative Finance, stated that ANGTS offers the State a potential benefit of \$5 billion (in today's dollars) over its 30-year life. This benefit is exclusive of any investment on the part of the State.

The meeting was adjourned at 3:15 p.m.

TO TESTIFY:

JOHN KATZ - COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES

DARRELL McKAY - NORTHWEST ALASKA PIPELINE COMPANY

CECIL CHAPMAN, ENGINEERING SERVICES MANAGER -
ALASKA ATLANTIC RICHFIELD COMPANY, INC.

KEN SHOWALTER - SOHIO PETROLEUM COMPANY

KIDDER-PEABODY PANEL

KEN SEPLOW

JOSEPH SCHFLL

OTTO LOWE

ROGER-PYLE-*no*

Hearing - Juneau
February 17, 1982

Betty Fahrenkamp: I would like to call this overview to order, and first thing off thank those of you who have agreed to participate today on such short notice, we really appreciate it. As most of you know, today's overview hearings are co-chaired by the Senate Resources Committee, and by the House Oil and Gas Committee, and the charge before us today is to gain an insight to be brought up to speed with regard to the progress and movement towards the possible financing of the construction of the Alaska National Gas Transportation System.

We approach today's hearing with a sensitivity that at this point negotiations are ongoing between Northwest Alaskan Pipeline, the national and international banking community and the North Slope producers. Today's focus is on information and education within those constraints, both of which are necessary for all parties to understand their roles and actions in ultimate completion of the project. This hearing, in nature of an overview, will be followed by additional hearings dealing with broader questions of policy and mechanics of the financing participation of the State, and the financing of the project.

As a point of background, in late November Governor Hammond recognized the need for the State to seriously consider its position vis-a-vis the construction of the Alaska National Gas Transportation System. The Governor organized a task force to specifically look at the general questions of the advisability of State participation in the financing of the System. The task force was constituted of Commissioners from the Department of Natural Resources, Revenue, the Attorney General, a couple of the Representatives from the House, representatives of Alaskans, and myself.

Our first witness today will be Commissioner Katz, and it is my understanding that he will be giving us overview of the task force basic charge and outline the task force activities to date in approaching the issue of State participation in the financing of the Alaska National Gas Pipeline. We also have with us representatives of Northwest to give us an overview of their efforts to secure a financing package and an update of their progress inasmuch as possible under their negotiation constraint. Representatives of the North Slope producers will address, from their perspective, just where the financing package is, as well as address technical questions related to the question of the effect of continuing re-injection of natural gas to the Prudhoe Bay field, and finally, we'll have interim report from the representatives of Kidder Peabody, an investment banking firm retained by the State to address the questions of financial feasibility of the project, and general questions of how the State's interests may be best served in the participation. With that out of the way, Rick, do you have anything to add?

Rick: I think I would just reiterate that we do understand the negotiating position that most of the participants are in, and I think it's important that we maintain a sensitivity to that negotiating position. I would hope that we get an adequate update of where we are and

maybe we can define some of the alternatives without prejudicing any future options that may be presented at a later date in the future reports.

Fahrenkamp: I think the procedure we'll follow is to have each group make their presentation, then we'll have questioning after each presentation, and we hope to be finished by 4:30 since the majority of my committee, I know, are catching planes for the coal conference in Anchorage and need to have me to be gone. Commissioner Katz?

Katz: Thank you, Madame Chairman.to the current efforts is a letter that President John McMillianGovernor in late November asking that the State reconsider its position on participating in the financing of the gas pipeline project. As a product of that letter the Governor, as you have already indicated, is the forming of a task force of the three Commissioners you mentioned and asked that the President of the Senate, the Speaker of the House, to make acquaintance as well, which was accomplished. We then went back to Washington for two principal purposes. First was to interview a number of possible investment counselors to the State on the pipeline issue. And out of that investigation we chose the firm of Kidder, Peabody for the State, on contract since that period of time. We also met for the first time with Northwest and its bankers in an effort to start the that is necessary to investigate all the alternatives. In the midst of those discussions of the gas pipeline waiver package passed the United States Congress. That package provided a number of waivers deemed very important to the financing of waivers of President Carter's original decision, and I think it was the general consensus of all concerned that while that waiver package was a necessary prerequisite to financing, it was not necessarily the only factor. The State examined the waiver package and felt comfortable with it and expressed strong support for during the congressional deliberations. We're responding in advance to questions which I think are likely to come. The waiver package is now the subject of litigation that has been filed by Senator Metzenbaum of Ohio and some other congressmen-senators. The principal allegations relate to the alleged violation of rules of the Congress and certain other technical aspects. We are advised by our lawyers that the lawsuit is pretty frivolous on the merits. It is pending in the Court of Appeals, there's an expedited review procedure there, but that any decision of the Court of Appeals can be appealed to the United States Supreme Court and there's at least some there will be more delay incident in that process.

As a product of our discussions in Washington we came back and formulated a work plan to govern the remainder of our activities. That work plan addresses two principal questions. Should the State participate in gas pipeline financing, and the second question - if so, how? The perspective that I think all of the participants in the task force have brought to those deliberations is one of hard-headed business people. We feel that we must look at all the same factors that the investment banking houses are looking at in their decision to participate in the financing, and then, in addition, look at certain other factors which are unique to Alaska as a State government, including the

impact on royalties, severance taxes, and secondary and tertiary benefits in the State's economy. We have formulated a number of subsidiary questions in an effort to respond to those two principal questions. They range from questions relating to the marketability of Prudhoe Bay gas to alternative investment opportunities that are available to the State of Alaska, and the impact of any particular proposal on the State's credit rating. Since the formulation of that work plan which we made available to both legislators and the media, we have been proceeding on two parallel tracks in an effort to answer those questions. On the one track, Kidder, Peabody, as they will indicate later, has been pursuing a number of questions. They have met on several occasions and exchanged information with Northwest and its financiers, and they are branching out beyond those discussions to interview other people with perspectives on the pipeline.

Secondarily, we have formulated an interagency task force of technical people and experts in particular disciplines to answer certain other questions which we felt were more appropriate for State's scrutiny and response than they were for the help of outside advisors. Those two parallel tracks will come together in early March in the form of initial findings and recommendations to the legislature and the Governor. At this point in time we're not certain exactly what form those findings and recommendations will take. We have condensed what might otherwise have been a very lengthy process into a relatively short period of time. I do think that the report will hit all of the major considerations in determinants that will influence subsequent decision-making and at that point in time we may also identify any other areas that might require further scrutiny in the future.

Fahrenkamp: Thank you, Commissioner. Before I open this with questions, I want to clarify the record. I think everybody knows this is Representative Halford, and not we'll get that out of the way right now. Sometimes I don't even know my own name. Are there questions from anyone? Go right ahead, Sam.

Sam: Thank you, Madame Chairman. I guess I had a couple questions, I wasn't sure how definitive you were on the advice that Kidder, Peabody has offered to us so far. That's one question, and secondly, you mentioned and I think most of us appreciate that the waiver package wasn't all that was necessary as far as the hurdles that the builders of the pipeline had to get over. How significant was that, would you say that was half the battle, more than half, less than half, and can you define the other significant hurdles that still loom in front of us?

Katz: I would be interested in the perspectives of the others too, but it is hard to quantify in percentage terms, I would say that its failure to pass would have been a determinative point in the process that the project would not have proceeded beyond that point. It does lay a good basis for future reference to formulate the financing package because it resolves a number of important concerns to financiers, particularly the issue of pre-billing. There is an allowance in their pre-billing prior to completion of the whole system. I would say that it would be risky to put it in percentage terms, the really key events

now, I think, are involved in Northwest's negotiations with the producers and with the other pipeline companies, another aspect of the waiver package was to permit producers to participate more in the equity financing, and that is an unfolding process where I don't think any one event is determinative but there is an effort to achieve sort of a critical mass of financing which Northwest hopes to do in the reasonably near future.

With respect to your first question, we originally felt that because of the short timeframes involved, Kidder would not have had the time to really to formulate any substantive conclusions that they could share today with respect to the financing issue and whether the State ought to participate. We have met with them this morning and I think thanks to their diligence and the real cooperation they have received from Northwest and others, they are going to be in a position to go beyond merely stating what sorts of activities they have undertaken so far and will be presenting at least some tentative conclusions on the basis of the work they have done so far.

Sam: Commissioner, do you expect them to, which questions do you expect them to get involved with? Should the State participate, or do you expect them to get involved with the second question, if so, how?

Katz: Well, each of those questions involves a series of subsidiary questions. Should the State participate does involve certain questions which we have asked them to express opinions on, the marketability of Prudhoe Bay gas, other concerns of that kind. Also, the question of if so, how, very much involves them, at least initially there were a number of competing possibilities or alternatives for financing, but in each of those questions, some of the questions are being answered by them, the subsidiary questions some by the State task force, for example, a question we felt, two questions that we felt we have better expertise on than any outside counselor might, would be, one, what legal constraints, constitutional, statutory, or others, might exist with respect to any particular option, and the second one is what alternative investment opportunities might there be for the State. But both questions as your question implies involved the major policy decisions and of course Kidder and I in my capacity as chairman of this task force, view ourselves only as advisors to you and the Governor, who will be making the ultimate policy decisions.

Representative Randolph: Yes, a follow-up on those questions, what timeframe do you see this all developing in? At what point are we going to have the answers to those questions and be able to consider them.

Katz: We think that we are going to have firm enough answers to give you advice that we feel is creditable in early March. Exactly when the financing package may come together is anybody's guess, but Northwest is making a real effort to do it in the first half of this year, and one of the options at least would be available for the legislature to consider given the fact that you may adjourn before the package has totally crystallized, might be some sort of a statement of principle in which you would identify those conditions and stipulations that might govern

any State participation, should you get over the initial question of should the State participate at all.

Fahrenkamp: Are there other questions? Representative Cotton.

Cotton: I didn't want to take more turns than was due me, but Commissioner, you mentioned that there might be an impact on taxes, severance taxes, depending upon what kind of a decision the State makes on participation, I wonder if you could expand on that a little bit.

Katz: Well, the crucial question is, who does the value to the State if the natural gas remains in the ground, I guess there's some who believe that that might in itself be a prudent investment. There are many others that feel that that's not the case, that the most prudent utilization of that resource would be for the State as a one-eighth royalty owner would be to market it. Certainly it is only at the time of production and transportation that our one-eighth royalty interest would quantify itself in terms of dollars and it is only at that point in time that the State's severance tax would become operative, so in addition to the factors that the banks are looking at, like the marketability of Prudhoe Bay, etc., that seemed to be a concern that was sort of uniquely Alaska's that we ought to try and quantify and address in a report to you.

Cotton: Thank you very much.

Fahrenkamp: Other questions? Representative Rogers.

Rogers: Commissioner, you said perhaps adoption of some sort of statement of principles setting conditions might be appropriate, would that be the kind of statement that was contained in the gas pipeline financing authority legislation in 1979?

Katz: Yes sir, something like that, I'm not trying to prejudice the answer to the first question, which is whether we should, but we have tried to sort of predict that in our effort to create a logical sequence leading towards State decision-making, and it probably will be the case that the financial package despite Northwest's best efforts will not crystallize within a 100 or 120 days, the deadline for adjournment, and it seemed to us that if you chose to go that route that that might be a good way of sort of signalling Alaska's interest, the State will participate if, or the State will not participate unless an actual (?) listing, a series of conditions, and it is my understanding that most of the major commercial banks that will be participating will probably participate on essentially the same sort of basis for the letter of commitment in which announced to a statement of principles that identifies those conditions under which we might participate. One advantage to that is that the State then if the State makes a decision to participate, would be a key player in the process and then in our judgment could influence other decisions that very much relate to State interests, for example the wellhead price, etc.

Rogers: At the time you said by early March you should have some firm answers, at that time would you be suggesting to us what conditions you think we might want to consider, again if the decision to the first question is yes at that time or if your suggestion is yes, would you be suggesting conditions to us?

Katz: Yes, the answer to your question yes, I've asked Kidder, Peabody to look at that from their informed expertise, and of course there'll be other issues that may well be of concern to the State government including the legislature which would not occur to outside advisors, and we would probably also at least propose those as options for your consideration.

Rogers: Thank you.

Fahrenkamp: Thank you Rogers, further questions so we can move on?

Q.: I'm sorry, I think, Madame Chairman, that Representative Rogers raised a very significant point there, I think, in that what instrument, are you suggesting that the legislature should pass a conceptual conditional statement of principle that would later be able to be negotiated as part of the financing package?

Katz: I don't want to get out ahead of the process and my raising this at all was an effort to respond to an earlier question about what sort of sequence from here to the end of the process and at least one option that may not be the only option, it is not one that I am suggesting now because we haven't gotten there yet. I can't honestly represent to you from the State's point of view this would be a good deal or not a good deal, from at least my personal point of view, because we haven't been exposed to the whole analysis and we're about three weeks away from that, but if we were to get over all those very important preliminary questions one method for the State to express its collective voice that would be cognizable in the financial community and would actually be of value in determining what the State's role would be, would be perhaps a resolution that embodied a statement of principles together with conditions and stipulations.

Fahrenkamp: Perhaps I can help there too, Representative Cotton, in that I may not stressed enough that this is strictly an interim report and those decisions are down the road, even though he's looking at early March, there's a lot of work to be done between now and then. Is that not correct, Commissioner?

Katz: That's right, and I think too, Representative Cotton, we're all in agreement that even if the process will ultimately lead to financing, probably that final decision will not be known, therefore at least known in March or April, therefore I don't think anybody would want to suggest that the State take some final action like appropriating x amount of money, or establishing a fund, or whatever at that point in time, and it isn't necessary, the financial community is not asking for that, Northwest is not. Some lesser alternative is the one we were discussing would suffice for this interim period.

Cotton: Thank you for your indulgence, Commissioner.

Q. Madame Chairman, I'm sorry but it seems to me that talking about the process, there may be further problems, obviously this legislature can't bind the next legislature into any action and again, if we were to pass something saying these are the conditions this legislature would accept or would want, the actual appropriation decision wouldn't be able to be made until after, since what you're saying after financing agreement were reached, would that mean waiting and presenting that to the next legislature, or would a special session to consider the issue, or how would you make the transition from if you didn't do it by special session, how would?

Katz: Well, you're obviously correct about the capacity of one legislature to bind another, that is a course known to all concerned in this process, Northwest, the financial community, et cetera. That is really not a determinative problem, I don't think, the financial community and particularly its public financing experts are used to dealing with that in all governmental situations in a number of contexts, and at some point further down the line, the quote moral obligation of the State might arise depending on what course of action the State had chosen to adopt up until that point, but I don't think that's a problem now and judging from what we've heard and you'll judge independently for yourself when you hear Kidder, Peabody, I don't think that there'll be the necessity for something like a special session. I'm hopeful that if we do our homework and you all deliberate carefully that we'll come up with a work product that we can answer the first preliminary question at all, a work product that's creditable enough to carry the State forward and be a reasonable game plan for a subsequent legislature.

Fahrenkamp: Further questions. Thank you very much. Darrell MacKay from Northwest Alaska Pipeline Company. Darrell, we appreciate you're being here, you know it was short notice, and I want to say thank you again.

Darrell MacKay: Thank you. Madame Chairman and Gentlemen, we're glad to spend some time this afternoon to tell you where we are on the project. I appreciate your admonition at the beginning, Madame Chairman, on the sensitivity of some of the negotiations that I'm not able to get into in any great detail, on the other hand I think I can shed some light on the process we're going through that might help remove some uncertainties. I know it seems like we don't hear what's happening and what progress is being made, from your standpoint, and I think I can help to some extent there.

1981 was truly a banner year in respect to progress toward completion of the Alaska Natural Gas Transportation System, and I would like to review a couple of the major accomplishments we felt were critical in 1981. Before I do that, though, I would like to pause and just remind ourselves of the objective that we mutually are trying to achieve and particular in light of some of the current world events which sure affect the progress we made and how rapid that progress is made. I just mention three things that has some impact on what we're trying to

do. One, is the extreme testing period we're involved in in the economic situation in our country, and that is certainly affecting us in our ability to put our financing together, and I'll enlarge a little bit on that later as to how we see it particularly, perhaps embellish on the question that Representative Cotton asked about what does the waiver package mean in terms of that oil financing. Secondly, there is an apparent, and I use that word advisedly, an apparent world oil surplus and declining real oil prices. There's also arguably a surplus of natural gas in the lower 48 states, and again I want to emphasize that the critical thing to keep our eye on in that respect is the long-term versus the short-term, and I'll try to enlarge on that more.

In addition we have some strained foreign relations in the U.S.-Soviet confrontation that's currently going on over a natural gas pipeline from serving Western Europe from Siberia. In spite of all of these difficulties and uncertainties there are nine major U.S. natural gas companies, of which we're one, three major U.S. oil companies that you're very familiar with here in Alaska, three major Canadian natural gas companies, the Administrations of both Canada and the United States, and the Congress of the United States, and the Parliament of Canada, and we assume as well, the State of Alaska, who all believe that connecting of these frontier far north reserves is in the best interest of the United States and to do it as quickly as we can. Often, those of us who are in the trees lose sight of the forest, that there is a tremendous weight of support for this project in both of these countries and while it may not be in flashy evidence to you from day to day, this whole group has devoted considerable time and resources to companies, particularly money, and I'll bring you up to date on that, to pursue the project, and that's still going on. There's no basic change in the expectation that natural gas will be in short supply, particularly later in this decade. Just an aside on marketability in light of this short-term situation as we see it, and certainly the consultant that we have employed to look at this issue, believes Alaska gas is marketable, even in light of the current oil situation. And that occurs in several ways. One way is that with any potential upset in the Mideast there certainly could be dramatically rising oil prices. Again, we tend to get lulled into a sense of complacency when there's a period of surplus and price reduction. Secondly, there is the aspect of what we call roll-in capacity, that is the ability to average the cost of Alaskan gas which we expect probably will be higher than the market clearing price when we first come on stream, but we can average that in with other lower 48 supplies and still market Alaskan gas. Thirdly, we recently completed some very interesting work on what we call a concept of cost levelization, and that is recognizing the real cost of Alaskan gas will decline, forgetting inflation, because the transportation systems being amortized over time and it's such a huge part of the cost, if we can move some of the earlier costs into the back years, we can compete very aggressively with low clearing prices, and so a combination of all of these things lead us to believe that Alaskan gas continues to be marketable.

It's incomprehensible to us as well, that Western Europe would be willing to rely on natural gas supplies from the frontier area of Russia while here in the United States we could not connect the largest

domestic gas field ever discovered in the United States to our own markets. While as I mention it it does take a lot of dedication, it takes a lot of willingness to accept risk to pursue the project in spite of the delays and obstacles that we've had starting back in 1976, and these delays and obstacles seem to continually pop up, but we believe we're periodically taking care of those as they occur, and we're moving forward. And I'm pleased to be able to say to you today that the commitment is still present and was considerably strengthened in 1981 by all of these companies and parties that are trying to bring this project to fruition.

Let me just pause to give you a few facts from the Company's standpoint. We will have spent, including the cost of money, or have spent, including the cost of money, at the end of '81 over 600 million dollars, in engineering work and all of the other things that have gone into firming the project to the point it is. In terms of the pipeline, we have accomplished about 35% of the detailed engineering, and that's very significant level of engineering. We have not encountered surprises from the geotechnical standpoint in terms of our ability to construct the pipeline, and within the cost estimate that was made in 1980. So we're pleased that the engineering work is proceeding well and that we have not encountered these surprises. About roughly a little less than 30% of that money has been spent in Alaska, which is going on every day and is again something I'm sure you are not aware of all of the time. Last year we had a peak employment of about 1800 people, an average of about 1400 during the course of the year, and somewhere around 25% to a third of those people are located in Alaska, and of that share that's located in Alaska, somewhere in the neighborhood of 75 - 80% were hired Alaskans to do the work. So we think we've done a good job in recognizing the needs of the State and the community in pursuing the project. The Canadians have been doing a similar thing with the people they have working on their aspect of the project, and while prior to 1981 the Canadians were generally ahead of us in terms of their progress, we believe we have now caught up and we're proceeding about on an equal pace. But this doesn't mean we're home free by any means, we're now in the midst of this extremely critical period of putting the project financing together, and that is a private financing plan with private capital. There's often been a misunderstanding that we've gone to the financial community and they have turned us down, and that is a misconception. The first time we went to the financial community represented by four of the largest U.S. banks was last summer after we had reached agreement with the producers on the concepts of a financing plan, and in working with the banks we've since modified that plan and are working very well together and the banks are very positive on our ability to put this together if everyone is motivated to do the job.

Now, let me just pause here for a moment to talk about two areas of accomplishment in 1981 that are important. One is the pre-bill project that I'm sure you have heard about previously which is the concept of building a portion of the system early to transport Canadian gas until the rest is completed for the connection of the Alaska gas. The ground-breaking ceremony for the Western Leg prebuild was held in February, and the Eastern Leg in May last year. The Western Leg

which is some 300 miles of pipeline in Canada and United States was completed and put in service October 1st, and we're now moving gas from Canada through those facilities to California. The Eastern Leg which is over 800 miles long plus another 400 in Canada, about 1200 miles total, is somewhere about three-quarters completed with the remaining construction to be done next spring and summer, aiming to put that in service in the fall of 1982, to move the rest of the Canadian gas to market. So in total, we will have built by this fall 1500 miles or about a third of the total pipeline system for the Alaska gas. An extremely important step forward and it has ramifications for you in Alaska as well, in that it's been a time of trial to see how the Government-Company interface works in this oversight responsibility, the Federal Inspector, and we think it's working well in those things that we are uncovering that need to be improved we can apply in the case of the Alaska part of the facility, so it's a good testing ground and it'll be helpful to all of us to achieve coming in on schedule and on budget. I might add that those facilities on the Western Leg did come in slightly under budget and were on schedule. We expect the same on the Eastern Leg as we now see it. So we are not experiencing the types of cost overruns. Agreeably, these facilities are less difficult, the Alaska facilities being the more difficult, but again we're learning from this whole experience and expect to apply that.

The next key event in 1981 that deserves some attention is the so-called waiver package, or the waiver of law that Congress approved in December and was signed by the President which removes certain obstacles that permit us to take this very vigorous hard run at private financing of this project. The first step was the agreement we reached with the producers on the concepts of a financing plan, and then in June we submitted to the President our version of what we thought was needed in terms of a waiver of law to permit us to privately finance. Thereafter followed numerous discussions with Senate and House committee people and the Administration people who were going to be involved in the ultimate decision-making of that package, and a lot of revisions were made, and I'd be kidding you not to say that the package as it came out was a lot less than what we went in with. However we think that it's still adequate subject to the final test of our ability to put all the financing together. The President then sent the waiver package to Congress in mid-October and that was followed by committee hearings--a committee in the Senate, two committees in the House, holding substantial hearings and then the vote of both the Senate and the House, and that was finally signed by the President in December.

Basically, what the waiver package did in three critical areas was this. First, it permitted the producers to own equity in the pipeline system which prior to that was prohibited. It was prohibited, however, in the original President's Decision that selected this route for the project, and so as the financing development came to fruition, it became clear that to do it privately we had to have producer assistance and so as it's now structured the producers can own equity in the system. Its subject later to Department of Justice review upon the structure to make sure that the producers don't have control of the system, but

that is the key problem, not whether they should own equity per se. So that was a very critical item to permit us to go forward.

Secondly, the Conditioning Plant was made part of the Alaska Transportation System. Prior to that it was a separate system and the costs of the system were to be handled separately, now the Plant is part of the system and we're structuring a tariff which would reflect the cost of that Plant in the delivered cost of the gas.

Thirdly, a change in again the President's Decision was permitted to allow the Federal Energy Regulatory Commission to establish a tariff which would provide assurance that debt lenders would receive payment when a segment of the system that they were investing in was completed. This was the pre-billing concept that Commissioner Katz referred to. From a lender's standpoint this was extremely critical to permit us to go forward, even though we don't expect this event to ever occur, and we're disappointed that it was taken so out of context down in the lower 48 and all kinds of misconceptions as what it meant, but we think the risk of it occurring is very slight, but, bankers are not in the business of taking any risks and we had to accommodate those concerns as best we could.

Those were the two key activities in 1981 that have really helped move us forward substantially, the pre-built project, its status, and the waiver package. But where are we now, and perhaps I need to embellish a little on the background from a financing standpoint because I know that's what you're most interested in. I mentioned the Producer Pipeline Plan that was agreed to in last spring was used. Basically, that plan provided for what we call "project financing", that is, that there would be no independent credit underlying the debt and the equity would be supplied by the participants. The producers in their part would have been responsible under than plan for 30% of both the debt and the equity of the project, and the course of conditions precedent to the whole thing working was that the Plant was going to be part of the system, which ultimately was done through the waiver package. There were other terms and conditions surrounding the plan but that was essentially some of the key features.

We then went to the banks to say, "look here's our plan, help us structure what needs to be changed in the law, (which ultimately came out as the waiver package) to make this thing work." Because of the early nature of the work, they were unable to say that they could assure that we could privately finance if the changes were made but they were able to say that without the waiver package as it was passed. they knew we could not probably finance it, and that's the posture we took at the time and have taken and now are working on trying to implement that. Now the banks in addition said, "you're going to have to make some changes to your original plan. The concept that you don't have to have credit, particularly during construction, will not work. In order to pull this off the sponsors involved, both the pipeline companies and the producers, are going to have to put their existing company credit behind the debt, or let's say most of the debt, in order to make this work." They also said that there's enough money worldwide in order to finance this project, which was a very

positive thing in their report, and this is critical because even with participation of say, the 100 largest U.S. banks, lending ...

... was very critical that, once construction is completed, we go into operation, then the tariff under which the charges are made and the ultimate gas consumer pays those charges, is enough that credit for the project to move ahead successfully, so it's only during this period of construction, or what we call the completion risk, that the banks were saying you've got to have more credit behind the project. Well, we got busy behind that situation and our companies were very disappointed of course, that the concept of project financing as we had originally proposed, was not going to fly. But, we regrouped ourselves and these companies have agreed that they're willing to support some portion of this project debt with company credit in a way that so long as it does not impinge on their other activities to do business in their regions and in a way that the banks can live with, and we are sure because of the experience on the Eastern Leg, which had similar problems, that this can be done. Well, the waiver passed and during that process I think it's important for you to know that in terms of not only the difficulties we had with some of the concepts in the waiver package, another continually nagging question we faced when we visited congressmen and senators and the committees that addressed the issue, was where's the State of Alaska, is the State supporting this, how are they going to support it, what meaning is there to attach that the State's not supporting it, and we're very concerned about that, hopefully, the Governor came down and helped support the waiver package, testified before the committees and Congress in a positive way, although there had been nothing, of course, put together at that point. I might just read one brief illustration of what I'm speaking about and this is in the House Energy and Commerce Committee report following all of the hearings, and so on. "The committee encourages the State of Alaska to examine the benefits of this project to its citizens as well as to the rest of the nation, to recognize the enormous positive effect that any contribution of capital or of credit security would have on the chances of the project to be financed, (and I would add privately which is our charge deal, and nothing's changed in that regard) and to act as promptly as possible in accordance with the conclusions of such an investigation."

I'll come up again back to the State's role and its importance to us, but this is very critical aspect, as a result we're pleased that the Governor established this task force and that the progress that Commissioner Katz just described has been made and is proceeding expeditiously. Following the passage of the waiver package then as Commissioner Katz described to you, there's been a court suit filed. We agree, as well, that this suit will not prevail, our lawyers are in the middle of this right now, but the grounds that have been raised are not, in our view, substantial enough to result in any change. However, we are concerned about the potential of delay and particularly in relation to the possibility of an appeal to the Supreme Court.

That is the background in terms of financing, now what's going on right now -- there's several things on simultaneous fronts that are moving forward, one is that the pipeline companies, and there are nine

U.S. companies, and one Canadian company, by the way, the nine U.S. companies transport 40% of the gas handled in the lower 48, so if we're marketing roughly 20 trillion cubic feet a year, these companies are handling directly about 8 trillion cubic feet a year of that, and their sales to their customers either directly or indirectly will go to all of the lower 48 states except Vermont in some manner. The percentage of Alaskan gas varies but it's spread very widely which is a very helpful thing to us again in terms of marketability. But these companies are determining and have determined and we now have in writing individually the commitments they're willing to make both in terms of equity and the amount of debt support that they're willing to stand behind. Now the four banks that are working with us to develop this plan, those banks being the Bank of America, Citibank, Chase Manhattan, and Morgan, are evaluating each of those companies to satisfy themselves that they can make that commitment. The banks are very concerned that, as the companies are, that they're able to carry out their obligations and still meet this commitment. So that process is going on right now. We're also working with the producers and will be as this pipeline work is completed on their commitment and how high that could be. We're also working with the banks to determine what portion of the debt would not have to be supported by the credit of the sponsors. We know there's some amount, the banks have told us that most of the debt will have to be supported, but there is some portion, particularly the monies spent late in the project when certain conditions have been met, such as being on schedule, on budget, those sorts of things. Late in the project we expect the banks could put a substantial amount of funds in on a non-recourse basis. But they're examining that and we're working with them. That involves a lot of schedule and engineering review to review that. The banks are also addressing the overall viability of the financing and how to structure it to best assure the chance of success, and so in a short period of time they'll be giving us their view of the terms and conditions they would attach to their commitment as banks to loan money to the project. All those things are going on right now and as you can appreciate there are going to be several knotty negotiation problems that will grow out of that, that we're pleased and I can tell you that there is a strong move on the sponsors' part, the pipeline sponsors, the producers, and the banks to get this job done and to get it done as quickly as possible.

How does the State fit into all of this? I was pleased to hear Commissioner Katz's description of how the State is going about its work and we certainly support that approach. We have tried to respond as quickly as we can to provide information to Kidder, Peabody that's necessary for them to make their analysis, and we believe we've been responsive in that area and will continue to be in as open a way as we can, again within the constraints of the negotiations that are going on. We think that this is the best way for the State to determine its role, and it's not better for us to be coming in and pushing some particular plan--we think it's better for you to address the question of should the State invest, and if so how, and for us to be responsive to be sure we supply everything that's necessary.

Now, I should clarify because it may come to your attention anyway, we're proceeding in our planning on the assumptions that the State might not participate, that it may be somewhat difficult, whether the State's participation was critical or not, we're really not phasing (?) on until we put the whole thing together, but we think that really begs the question. We believe that the correct approach is to answer this key question of should the State be an investor, as any business venture. We're confident we can demonstrate that it is an attractive investment, and that we can make it attractive to the State to do that. In that way the State's participation will grow naturally and we think would grow in the right way in such that the important psychological impact of the State being part of this will have been accomplished in the best way possible. But we're working hard to finalize this final financing plan and then to get the final regulatory approvals that are necessary in order to start construction. We hope that you participating with the Administration will decide that the State should be a part of this and that this would be an important piece of your realizing the huge benefits that will accrue in the connection of transportation, sale of Alaskan gas.

Let me close and describe very generally what kind of help we think would be the most beneficial to the project, without in any way trying to usurp because it's not appropriate for us, presumptuous of us to in any way try to tell the State what the best thing to do is, but from strictly a project's standpoint, the type of assistance that we think would be most helpful would be some appropriate guarantee of a sure, of project debt, either during the construction period which would be a shorter time period or State funding of a sure of long-term debt, which could go on for any period of time that could be worked out. There are ways that such a guarantee might not have to be drawn upon and I'm very interested to hear what some of the work Kidder Peabody is doing in this area, and further we think that the State could be paid an attractive and appropriate return on any problems without committing to the project to make it an attractive business deal. All of those things however are best left to the State with our providing information to determine.

Madame Chairman, that completes my remarks, and I'd be glad to try and answer any questions you might have. I might say I brought along our last Alaskan Newsliner which has some pretty good summary material and goes through all of the things that occurred in 1981, and I'll leave copies of this with you. Some of you may have it but I'll leave that with you.

Fahrenkamp: Thank you very much Mr. MacKay. Are there questions on the part of?

Q.: Yes, Mr. MacKay. I have something I would like to have clarified in my own mind. This is marketability situation, and maybe a brief description from you on just what the pre-billing entails for consumers outside and how serious that is, and how significant that is in total value.

MacKay: Okay.

Q.: Try to, ... question that is that all the information I have is, you mentioned the supply of natural gas on a shortrun basis and ... surplus and a ... do not have, but a lot of good information indicates that there is for a good long time in the future, not a shortage of natural gas, and that fits into marketability question also, would you just ...

Mackay: All right, let me tackle the last part first perhaps, including in context. One very significant example to me that our consultant has raised in respect to his question of the shortage of gas or the surplus of gas, is the amount of reserves in one area of the United States, just to use an example, or to make a point of how rapidly existing reserves are declining and how difficult the job is just to keep up with those declines, the South Louisiana area of the United States has about 35% of the reserves, excuse me, that's turned around, it's 25% of the reserves, but we're taking 35% of our annual production from those reserves in just one small geographic area, that's 7 trillion feet out of the 20 approximately each year is being produced out of South Louisiana. That rate of depletion is about 16% per year of the reserves that are there, so it's a quarter of our reserves and we're producing at that high rate. Now that'll decline, you know at that rate it would be gone in five years unless it's a huge amount of reserves, but it's only declined for, but it's nevertheless an example of the very important decline. A lot of the reserves that are being added, such as the well known overthrust belt are very low producible reserves, so you have to add a lot more reserves to replace what you're taking from South Louisiana, than what's in South Louisiana from a reserve standpoint. So there is a very precipitous decline particularly in the latter part of this decade, and that creates a good part of the need that I'm discussing here.

The marketability question, as I mentioned we feel confident that through a combination of those three things that first, either the gas may be incrementally saleable anyway, that there's, you know we had three major disruptions in Mideast in the decade of the 70's and it only takes one of those to add 50% or 100% to the price of oil, and so we're still in that tenuous situation, and that price affects clearing price for gas in the United States, whereas oil prices rise so does the clearing price for gas.

Secondly, we have this ability to average the cost of Alaskan gas in with other supplies, and then, third, we have this levelization method to move costs from the early years to the back years. Now we're not the only ones that have to be satisfied on marketability, the shippers, the people that are committing themselves to buy this gas have to be satisfied, the banks have to be satisfied, and so on. So all of this will be reviewed, but we're confident that we have the tools to assure that Alaska gas will be marketable.

Your last point, and I think first question in terms of the pre-billing issue, perhaps, to put that in context the first of all, nothing can happen under the legislation as it has been passed before a date certain and that date certain is the expected date of completion of the whole project, Canada and Alaska. That date is to be set by the Federal

Energy Regulatory Commission consulting with the Federal Inspector. So it's an independent objective outside look, it's not the project people setting the date. So they're going to be very concerned to assure that that date is set at a time that can be met. Right now we're talking late 1986 or 1987, then nothing could happen in terms of billing to present consumers before that date. Now after that date, if one of three of the major segments of the project is completed, but others are not, the three segments are the Conditioning Plant, the Alaska pipeline, and the Canadian pipeline as a whole. If one of those is completed, let's say Canada's complete on the target date, but for some reason we've had a delay in Alaska on Conditioning Plant, then present consumers at that time could be charged for the cost of the Canadian system, because it is now complete and ready for service. As I mentioned early on, we think the chances of this kind of thing occurring are remote because we will be close to coordinating the schedule, we know a lot now about what is schedule sensitive and how we can accommodate problems as they occur, so we think the chances of this occurring are remote. Now, however if you took that illumination of that risk to get this project done on a private basis, we're trying to do that, that seems to us to be a small risk for the consumer to take in order to assure the very large benefits that he will get over the life of the project to get this gas supply, and that was the ultimate decision that a lot of the Congressmen decided was important from their perspective.

Fahrenkamp: Are there further questions? Representative Cotton.

Cotton: I have a couple questions, if you're trying to get this thing over with in a hurry I won't ask any questions.

Fahrenkamp: I'm not, I'm just smiling, I have a 4:30 deadline and we have three other people to hear from.

Cotton: Okay I got a couple questions, I'll try to make them real brief. You mentioned as of end of 81 the company had spent 600 million dollars on the project, does that figure include the cost of the so-called prebill in the Western and Eastern Legs so that prebill?

MacKay: No it does not. That's strictly the Alaskan partnership that includes none of the lower 48 systems.

Cotton: None of the Canadian?

MacKay: None of the Canadian.

Cotton: So of that money and all the people you're talking about that were working, the 1400 average, the 1600 workforce peak, that was all dealing with the Alaskan portion?

MacKay: Correct, does not include the Canadians or does not include all the work going on on the prebill. That's all separate. And the prebill itself interestingly which between the two countries is between two and three billion dollars, two and a half say, the Eastern Leg in the United States which was a total of about one and a half billion dollars is the largest private again financing ever done on the gas

pipeline in the United States, where again we tend to forget the magnitude of some of the things we're dealing with, but that was done and done successfully on the part of the ...

Cotton: I've been playing around with your figures here, correct me if I'm wrong, 25 to 33% of those jobs were in Alaska and of those jobs 80% were Alaskans, so I get down to about 1 of 8 of the jobs that have been associated with the pipeline in Alaska have been Alaskans who have been hired, would you say that I've unfairly manipulated your figures by saying that 1 of 8 jobs are given to Alaskans?

MacKay: Well, I think yes it is unfair and I think the fair way to look at it is what have we done in respect to the people that are located in Alaska. You know it's tough to say you can attract Alaskans as much as they love this country up here to California or Utah or Washington to work on the project, or Houston, but of the people that have been brought on of the total complement in Alaska, the key figure is this 75-80% have been Alaskans. We think that's darn good performance.

Cotton: Of the jobs that are in Alaska?

MacKay: That's right.

Cotton: A couple of real quick questions, right now the Western Leg is sending Canadian or Alberta gas to California, is that correct, as it's operating as of the first of October?

MacKay: That's correct.

Cotton: And the other Leg will be operating this fall, last thing that the National Energy Board in Canada has allowed, as only a certain timeframe for a commitment of Alberta gas that you're able to use, I understood it's about five years, is that correct?

MacKay: The licenses under which that gas is moving varies between the two legs but it's about an average of six.

Cotton: Okay, so what would happen if the National Energy Board didn't allow any further export from Alberta to the West Coast of the United States, would that pipeline then have to just wait until the Alaskan section got through, or I suppose you'd pursue other alternatives, but that would be the point it would be empty until Alaska's gas came on board, is that correct?

MacKay: That could happen, we don't expect it to happen, the National Energy Board is right this year having what they call an omnibus export proceeding to look at all exports to the United States and our group is back in looking for an extension of those licenses to go further because companies in our group need both the Canadian and Alaskan gas which comes back to the question of need and marketability that they're really pursuing both supplies. The contracts are for 12 years, initial term of the contracts is 12 years and we're trying to extend the licenses.

Cotton: Okay, so probably then your goal is to get Alaskan gas to where in Alberta is the hookup there?

MacKay: A place called James River.

Cotton: James River, so you want to get Alaskan gas to James River probably sometime in 1987 or 1988, is that what you're still shooting at?

MacKay: Well our current schedule is late 1986, we're really currently about reevaluating that in light of where we are, what happened on the waiver package and we'll be able to address substantially where we are on that schedule next month.

Cotton: Do you expect to have it later than late 86 then?

MacKay: That's very tight. That schedule is very tight.

Cotton: Late 86 is very tight, does that mean that you still expect to really meet that?

MacKay: It could be met but it's very improbable at this point.

Cotton: You don't want to, your most probable date -- if I step over these provinces of sensitivity please let me know.

MacKay: Yes, no we really are very thoroughly re-evaluating that in terms of the steps on financing, regulatory steps and construction, and we will be in a position to lay that out particularly to the Federal Energy Regulatory Commission next month.

Cotton: In terms of other re-evaluations, when somebody asks you these days what is the total cost of the project, what are you saying these days?

MacKay: Well, let me try to put that in context, and I'll try to deal with some ranges because I think that's the best way to get a feel for this, there's a lot of ways to present capital costs so one must be sure they understand what is being presented. The first figures I'll give you are 1980 dollars so we are not including either contingency or interest on debt during construction in these figures.

Cotton: Without contingency -

MacKay: Excuse me, not contingency, inflation or the interest on debt during construction.

Cotton: Without interest on debt during construction?

MacKay: The total project, including Canada and the lower 48 and including the facilities now under construction, the prebill, varies from about 17.5 billion dollars to 23 billion dollars with and without contingencies, in other words, in the lower figure there are no contingencies and in the higher figure we have provided both what we call normal contingency and abnormal events.

Cotton: 17 to 23 is the range without inflation and without interest on debt during the construction period?

MacKay: That's right.

Cotton: So you're gonna add those to, just putting it in perspective, what you're doing?

MacKay: That's right. Now to bring those figures in, of course one has to assume inflation rates and interest costs which is at best a difficult thing to prophecy.

Cotton: Excuse me, just one real quick ..., since the Conditioning Plant is now part of the System, I assume you're adding the cost of the Conditioning Plant in with the figures you have just given me?

MacKay: Yes, the Conditioning Plant is included in those figures.

Q.: Excuse me.

MacKay: Yes.

Q.: In the 17 and a half to 23, does that, did you say that that included the Eastern Leg and the Western Leg and the prebuilt system?

MacKay: ...

Q.: ... I think that's what you said for the Eastern Leg, or over a billion anyway, that somewhere between a billion and a half, two billion dollars has been already spent or committed?

MacKay: Yes. That's right, and now when I get to inflated numbers it's easier to deal with that because those facilities are being built early so I'll put that in perspective with you on the total project. Now, if we look at inflation rates in the range of say 7 to 11% and interest rates in the range of 10 to 14%, the costs of the total project again would vary from roughly 39 billion dollars to 48 billion dollars. I want to stress there that you can, to see the importance that inflation and interest have on the total project costs, as you can see it's over half of the cost, now of that range about two and a half, or a little over to 2.7 billion, depending on the ultimate cost of the Eastern Leg will have been the prebill, so the net cost after prebill for the completion is in the range of say 36 billion to 45 billion dollars, and I'm sure you have seen publicized the figure of around 40 which is generally in the middle of that range. Again that's inflated dollars and including interest on debt and its important to recognize how big a share of the total cost that is.

Cotton: Is that a recent estimate and do you expect to have a re-evaluation of those numbers any time soon?

MacKay: We are as a group of sponsors very carefully addressing what amount of money needs to be financed and that involves estimates and inflation and so on. I don't expect that that would be outside of this

range that I just presented, that that's pretty good part of the overall financing activity. This estimate by the way, was the base behind this estimate particularly the pipeline was made in 1980 was filed with the FERC in mid-1980 and we filed some recent adjustments to that base but that base has held very well during the course of the additional field programs that we've done and engineering work we've done, so we're confident in our cost estimate.

Cotton: One final question, you finished your remarks with a discussion of what forms the State's participation might take and you were very careful to phrase it in a way that wouldn't offend the legislators up here, I suppose, but you suggested though both times that the debt was the area that the State should consider if we were wanting to know what your preference was, and you didn't mention equity, and maybe I just misunderstood what you had to say but you considered short term or project debt the first preference, long term debt the second preference, and please correct me if I'm wrong, and then you didn't make any mention of an equity investment by the State, maybe you could expand on that a little bit as to why you left out equity, or in fact did you leave that out, as more -

MacKay: In terms of our preference, yes, and there are a couple of reasons, one, we are able to raise the equity with the present group's sponsors that are supporting the project that we're able to include the producers as we may now do in the, under the waiver package that was approved, so our difficulty in putting the plan together is not with equity, we can put together the equity appropriately.

Secondly, we see some difficulty from the State's standpoint in participating in equity because of its dual role as regulator as well as investor. Now there may be some ways to get around that that could work, and we're certainly open to discussions of any nature, I don't want to foreclose any discussion that may be fruitful in this area.

Thirdly, we had observed and this was back in 79 but when Governor Hammond at that time was writing the President describing the status of things he said this, he said "I must note that in my travels through the State I have seen little support for the concept of equity participation in the line because Alaska's citizens believe that the project is strong enough it will be able to attract equity in private capital markets. So putting all that together we just haven't pursued that.

Fahrenkamp: Are there other questions. Thank you very much Mr. MacKay.

MacKay: Thank you.

Fahrenkamp: Cecil Chapman, Engineering Services Manager for Alaska, Atlantic Richfield Company.

Chapman: Madame Chairman, my name is Cecil Chapman and I'm with Arco Alaska in Anchorage. Just by way of background I've been in Alaska since 1969 and have followed the development, initial

development ... startup in production and now forward planning for Prudhoe Bay fields. My purpose in being here today is to share with you a statement which has been prepared by the Prudhoe Bay working interest owners regarding the effect of delay gas sales on Prudhoe Bay performance and development. Copies of the statement have been furnished to you, it's a three page statement, I would like to paraphrase from the statement at this point. Prior to the field going on production in June 1977, a gas sales of 2 billion cubic feet per day were anticipated starting as early as 1982. All of the studies done by the major working interest owners indicate that the optimum operating plan for Prudhoe Bay includes early gas sales, and that the reservoir can be managed such that the gas offtake will have little or no effect on ultimate oil recovery. Considering that the Prudhoe Bay unit gas and associated liquids are approximately equivalent to one third of the total recoverable hydrocarbon reserves of the producing reservoir and that simultaneous oil and gas sales can allow lower economic production limits in abandonment, the unit owners certainly very strongly support early gas sales. With regards to reservoir performance and plans and the impact on these areas the performance of the Prudhoe Bay Sadlerochit Reservoir is and will be for some time dominated by the expansion of the large gas tap. Assuming that gas sales occur by early 87 production of gas will have increased to the point that the entire production volume to support 2 billion cubic feet per day of sales can be produced from the oil wells, and I might clarify that the with the expansion of the gas cap into the oil rim area we're seeing increases in gas/oil ratios and wells such that the producing oil wells will actually allow the production of the gas volumes that will be required in order to satisfy the gas pipeline demands.

The associated gas production that is produced in excess of the fuel and other consumption requirements is currently being re-injected into the gas cap by use of the central compressor plant and this will continue to be the case until the start of gas sales. Now with the startup of sales the field gas handling capacity will increase by approximately 500 million cubic feet of gas per day. The central compressor plant as it sits there today and incidentally, this past summer we just brought up a 13th compressor unit there which allows us to achieve an inlet volume to the gas compression plant facilities of approximately 2.1 to 2.2 billion cubic feet of gas per day. With the startup of sales we would add a field offtake of about 2.7 billion cubic feet per day and this is specified in the field rules for Prudhoe Bay units, and this would allow us to increase up to this additional level of 500 million cubic feet of gas per day. Now this increase is significant in that it does allow an increase in oil production from high ratio wells and initially this increase in oil production would be something on the order of a hundred thousand barrels of oil per day. Now the benefit will erode of course with further increases in gas production, but expansion of the gas handling capacity will allow us to provide incremental oil production for some period of time. A delay in the commencement of gas sales is not really expected to have a significant effect on the ultimate recovery of Prudhoe Bay. In previous public testimony the unit working interest owners have stated that delay in gas sales until substantially all of the oil has been recovered could increase the oil recovery approximately one percent of the original oil in

place. Less drastic delays on the order of say one to three years will have an even smaller effect. Also gas sales timing impacts on oil recovery are tempered by the initiation of a major water flood in 1984 to which the unit owners are already committed and this project is very much on schedule at this point.

With regard to operating in facility impacts significant delays in gas sales can have a major effect on field facility and operational requirements. In the absence of gas sales in the 1987 timeframe additional facilities would be necessary to provide the equivalent field gas handling capacity again due these increased gas/oil ratios if we're to maintain the production of - these additional facilities and these would be compressors and lines and additional wells and so on, would result in extra capital operating and maintenance costs of about 150 to 200 million dollars for the producers. More importantly continued injection of gas back into the gas cap consumes more forms of energy, each year the gas sales are delayed would require approximately 30 billion cubic feet of fuel gas or the energy equivalent of over 3 million barrels of oil.

By way of summary the objective of the Prudhoe Bay field producers is to achieve the maximum economic recovery of oil, gas and gas liquids. Studies have shown that with sound reservoir management which includes this very large commitment to water flood in 1984 all of the interests in the field can be best served by simultaneous production of oil and gas. This can be achieved by early gas production through facilities installed for oil production and a long term by prolonging the oil production while gas production operations continue to be viable. These combined effects can be maximized by the early realization of gas sales. Delays in gas sales carry penalties associated with the fuel consumed in re-injecting the gas which cannot be sold and with the potential burden to provide extra gas handling facilities to sustain oil production at economically optimum rates.

I guess by way of summary the feeling and certainly the conclusion of the producers is that we very definitely support early gas sales and appreciate very much the interest that this committee has and we appreciate all the support too. I think it was stated in the outset that I would also be speaking to financing, that had not been part of my plan today, so at this point I tender myself for questions.

Fahrenkamp: Very well, are there questions from members of the committee.

Q.: So your point is, you favor construction of the gasline, you don't think it's going to hurt your oil production, is that your point?

Chapman: Yes sir, that is correct.

Q.: Thank you.

Q.: Madame Chairman, if I could?

Fahrenkamp: Senator ...

Q.: In the prepared text, I'm assuming that this was what you were reading from?

Chapman: Yes sir.

Q.: There are several references in here, the gas liquids, and gas, and in your summary, oil/gas and gas liquids, and of course we've all heard the studies about the gas liquids through the Dow-Shell Study, and the producers were a major part of that study, and because of the reference in here, has there been some decision reached in the design of the facility where there would be a ... attempt to separate gas liquids as this financing goes forward in the line?

Chapman: As part of the gas conditioning facilities for the pipeline?

Q.: Yes, in other words the gas conditioning facility now is part of the pipeline, and what, I guess what I'm saying is, what's the status, is that gas conditioning facility going to be set up so that gas liquids can be extracted at Prudhoe Bay, Fairbanks, or has that decision been reached, and maybe I'm even asking the wrong guy, I don't know.

Chapman: Yes sir, I think I would really rather refer that question to Mr. MacKay, he can probably speak more effectively to that particular aspect of

Fahrenkamp: Are there further questions?

Q.: Madame Chairman, with your indulgence I would like to ask that question of Mr. MacKay.

MacKay: I'm sorry, could you repeat that, I couldn't quite hear all of it, in back,

Q.: In the producer's statement here, they make references to not only oil and gas, but gas liquids, and my specific question is, has there been or is there an attempt to be a design of the conditioning plant, so the gas liquids may be extracted at Prudhoe Bay, or Fairbanks, or has it been addressed yet?

MacKay: ... (gap on transcription) additional material out of the gas stream, but the initial design of the plant to extract what's necessary to make the gas transportable through the pipeline.

Q.: Through the pipeline?

MacKay: Right.

Q.: Okay, what happens to the rest of it, because obviously not all the gas liquids can be transported down the pipe, is that re-injected under the scheme now?

MacKay: The present design in, and I might say that all of the contractual arrangements surrounding this situation has yet been put in place as between the producers, the shippers, and the plant itself, but

the design contemplates that some of the liquids would be blended with the fuel gas stream that's used on the North Slope, some of the liquids would be transported or blended with the oil and go through the oil pipeline.

Fahrenkamp: Representative Bettisworth.

_____(?): I'm through for a second, I want to think about that last one.

Bettisworth: Okay, thank you Madame Chairman, in regards to the gas liquids, as a percentage of the gas liquids in the gas that will be extracted, what percent's going to go down the pipeline? If your gas volume runs 16-18% gas liquids, how much of that, those liquids are going to go into the gas stream, or go down the pipeline?

MacKay: Oh, I'm sorry I can't answer that question. I don't have in mind the, how that is, how those volumes are shared.

Bettisworth: If I may pursue this just a, just a touch, Madame Chairman. Most Alaskans and myself included are particularly interested in the gas liquids because of the value added possibilities, even for just minor manufacture, and the gasoline that's going into the States is a dry gasoline so those liquids are going to come out somewhere, and apparently they are going to come out somewhere in Alberta, and they're gonna be should be in such volume that the large percentage goes down the pipeline to create a substantial petro-chemical industry, and recognizing that they all, there is an existing industry in Alberta that could probably handle it, Alaskans would very much like to have something like that up here, and that's going to I'm sure be weighing heavily in the minds of those legislators who are looking at any possibility of help in the financing field as to what happens to those liquids, and I for one feel quite strongly that way and I think there probably are others.

Fahrenkamp: Representative Bettisworth, I'm sorry that we did not in our invitations to them or in any way prepare them for the questions that they're getting now, (babble), are there further questions?

MacKay: Just one quick comment, there will be no liquids extracted in Canada, I can assure you that. This will be a separate system and the contractual arrangements and the tariff arrangements will assure that that does not happen. It is contemplated that what would happen is that the gas, the heating value that's present will be sold in the form that is delivered.

Q.: Madame Chairman, if I may?

Fahrenkamp: Representative Ray (?)

Ray: Recognize that the gas liquids increase in BTU value, cubic foot gas considerably, your suggestion that is not going to be then dry gas exported from Canada into the lower 48, that it will have a liquid gas mixture in it that will increase the BTU's?

MacKay: No, technically it's difficult to directly address what you're getting at, if the stream can be gaseous or vapor and still have hydrocarbons in it that could be liquified, for example the component that's most valuable for petro-chemical development is ethylene, in order to make ethylene, well that's a very common part of natural gas stream delivered every day in the lower 48, and it doesn't take a liquid form unless it's specifically extracted and used as a separate product, so I think the answer is yes, the material stays in a gaseous form, it's still dry gas in that sense, it's not in liquid form as it's delivered to the consumers in the United States. Does that help somewhat?

Ray: To a degree. Okay if I may just one more and then I'll be quiet. I wouldn't expect that you'd probably answer this right now, but somewhere hopefully in the very near future somebody will answer it, but it's been rumored and I will concede that at this point it is strictly a rumor and there's lots of talk and hearsay about what's going to happen to this fabulous gasoline, that liquid rich gas from Alaska which is supposedly a lot higher BTU content will be traded for dry gas in Canada for a largely increased volume, in other words a cubic foot of rich gas for less rich gas to expand the volume that will be exported to States for sale.

MacKay: I can tell you that there is no substance to that at all with one very minor exception, and that is that we do expect to work out some arrangement with the Canadians to provide gas service to some small communities in the Yukon and that not now receive service, but it would not be for the purpose of liquid extraction, volume is very small so that would be the only exchange of ... ever been discussed, and I'm sure I would know about any such discussions as that heat content of gas is a very critical thing to shippers (garble)

Q.: Very good, thank you.

MacKay: Right.

Fahrenkamp: Thank you very much, are there further questions of Mr. Chapman? Thank you very much for participating, we appreciate it. Ken Showalter from Sohio.

Showalter: Thank you, Madame Chairman. I'm Ken Showalter, Director of State Government Affairs for Sohio, and the previous witnesses have pretty well covered the subjects at hand and most of what I might have said was covered in more detail and probably with more expertise than I could have done, and I'm sure that Kidder Peabody panel will do the same on the financing issue from their perspective, so I'll keep it very short and try to respond to any questions you might have and help you along on your 4:30 schedule.

I do want to emphasize that Sohio is seriously pursuing this project and that's evidenced by an expenditure by our company to date of some 40 million dollars in studies for the project and we've been active in the various negotiations and hearings in various forms regarding the project. A lot of hard work has been done by a lot of people and is ongoing to make the project a reality. We intend to pursue those

efforts to an ultimate conclusion which we hope is the completion of this transportation system that will allow us to sell the sizeable volumes of gas reserves that we have at Prudhoe Bay. Whether or not the State participates in the project obviously is a question that can only be answered by this body, the legislature. Sohio can't answer that question for you. We recognize that the State must follow this very important matter in the manner that they're doing and we would only counsel that if you come to the conclusion that it is a prudent thing for the State to participate in one manner or another that it be done in a pure investment sense comparing it with other investments that you might have and comparing the benefits and the costs of all of those projects. Beyond that I don't have a lot to say, our invitation included the same question that Mr. Chapman responded to, Sohio is fully in accord with the position that he laid out, our engineers participated in working up that response some time ago and all of the unit owners are in fact in agreement with that statement. With that I'll try to respond to any questions, I'm not a finance man nor a petroleum engineer, but I'll try to respond.

Fahrenkamp: Thank you, Ken, are there questions from members of the committee?

Cotton: Madame Chairman, I think that he answered my questions by saying that he had the same position that the other producers had, so that answers the question I might have had.

Fahrenkamp: Thank you Representative Cotton. I would like to invite the full team of Kidder Peabody at this time, that will be Ken Seplow, Joseph Schell, Otto Lowell, Roger Powell, as you speak identify yourselves for the record, and welcome to Juneau.

Q.: Madame Chairman, suppose we take five?

Fahrenkamp: Five minutes, yeah. We're ready and in good shape.

Co-chairman: As the House Co-chairman I'll call the meeting back to order. Senator Fahrenkamp had to go and take care of another matter, hopefully she'll be back in a few minutes. If you would go ahead with your presentation.

Joe Schell: Thank you Mr. Co-chairman, and members of the Joint House/Senate Committee on Oil and Gas Resources. I am Joe Schell, I'm Director of Kidder Peabody and Director of our Alternative Energy Group within our Corporate Finance Department. With me today are Ken Seplow to my right who is the Vice President of Kidder Peabody and Co-director of our Project Finance Group, and Otto Lowell, also a Vice President of Kidder Peabody whose enviable job is to look after our business in Alaska. One of the other members of our team who is in Alaska today but has left Juneau for Anchorage is Roger Pyle (?) who is the Vice President of our Municipal Finance Group and also a member of our Task Force dealing with our assignment for the State of Alaska.

First of all we thank you for the opportunity to come today and present you with our preliminary findings and I stress the word preliminary from the analysis that we have been doing over the last 45 days since we received the assignment for the State. As Commissioner Katz mentioned our assignment has been primarily focused on two questions. One, should Alaska participate in the financing plan for the Alaska Natural Gas Transportation System, and if the answer to that question is yes, then how should they participate. What is the most appropriate form for the State of Alaska to participate, given its other interests.

To date Kidder Peabody has been, my associates and I have been very active in holding meetings, reading all the various information that has been available on the pipeline and its progress to date. To give you an idea of what has been accomplished, we have had 4-5 meetings with the sponsors to discuss such things as their financing plan, the status thereof, the cost estimate and when that might be relooked at, the marketability of gas, their financial model which shows the returns available to the various equity sponsors of the project if everything goes according to plan, and also had discussions with their offices in Washington concerning the schedule for the FERC proceedings which will be upcoming later this year.

We have also met with the design engineers, being Fluor and Parsons, Fluor on the pipeline and Parsons on the Gas Conditioning Plant to discuss in greater detail the cost estimate to assure ourselves that the cost estimate procedures were realistic, based on our knowledge of how you go about that, and in determining how much sensitivity there is to the number which Mr. (?) ... out for the cost of the Alaskan portion of the pipeline. We have also and most importantly, had constant interaction over the last month and a half with other members of the task force from Commissioner Katz's office and Commissioner Williams' office particularly.

Our preliminary conclusions are as follows: First, our belief, based on our analysis to date is that the Alaskan Natural Gas Transportation System is the most viable alternative available to deliver Prudhoe Bay gas to the lower 48 within this decade. That there really are no other alternatives available, and it by itself is a viable alternative. We do not see any significant technical problems in building the pipeline, we believe the cost estimate procedures which have been followed and the cost estimate which has resulted appears reasonable at this time given the amount of engineering which has been accomplished, and although we are less certain of this conclusion it appears to us that the gas is marketable in the lower 48 states, that there may be a requirement to pursue such items as levelized tariffs to accomplish that fully.

We have been struck with the fact that all parties are working on the financing plan are doing just that, they're working very diligently to put together the financing plan. When we first received the assignment we were very hopeful that we could talk to the sponsors in our first meeting and have a full financing plan laid out before us. I think we became more understanding of the difficulty of that and you should be aware of that, that with ten project sponsors pipeline companies as project sponsors and three producer companies, it is a very difficult

task to get thirteen people to agree to anything. A financing plan is a very difficult procedure as was explained earlier by Mr. MacKay, the bank reaction to their first plan has altered their approach that they have taken, the project debt was not appropriate for the project, that the need for credit support to be provided by both the producers and the sponsors, that increases to a great extent the potential liability and potential investment of the various participants and it takes a great deal of time for them to come to an understanding internally within each company and agree among all thirteen companies as to how they want to proceed. That is one of the reasons I think it's taken as long as it appears to have to put together a financing plan, but it's very clear to us that everyone has diligently worked and could do that.

The third item among our preliminary conclusions are the following that we believe that the transportation system has definite net benefits to the State. Measuring those benefits is a difficult procedure and is not part of our assignment at this point, but from the work that we have studied on the national net benefits analysis which had been done before and some of the state net benefits analysis which is ongoing right now, we believe they're very significant benefits to the State in seeing that the Alaskan Natural Gas Transportation System becomes a reality.

The sponsors and producers in the ultimate financing plan when it does come to the forefront will be committing huge amounts of their capital, both on an absolute basis, talking about numbers that are in the 20 billion dollar range, 20 to 30 billion dollar range for the total pipeline system, most of that both in the form of equity and credit supported debt will come from the sponsors and producers. So the absolute amount is huge, the relative amount of financing that they would be responsible for relative to their existing businesses, their existing asset base, is also very, very large. However, it is also apparent to us that with those huge commitments made by those thirteen companies in their pro-rata share there may be and most likely be a need for additional financing beyond that as was mentioned earlier by Mr. MacKay, a portion of that financing may be accomplished on the basis of the project itself, provided that financing is put in towards the end of the project, and the issue which we will be addressing shortly, the State may have a role to play in closing that financing gap over and above the significant commitments made by the sponsors and the producers.

We feel that support for a financing plan by the State of Alaska at this early point can only serve to enhance the probability that the transportation system will go forward and become a reality. That that form of support not only the dollar amount, but the statement of an expression of interest in seeing that this becomes a reality, is very important to the pipeline's success at this point in time.

And lastly, we believe that Alaska can support the financing plan with very minimal risk on the part of the State, and my associate Ken Seplow will discuss our preliminary thoughts along these lines and we will be obviously available to answer any of your questions as they come up. I would again stress that what we are trying to do today is verbalize what we will be putting in writing shortly at the direction of

the task force so in the next three or four weeks trying to give you a sense of where we are today in our analysis of what options the State has available to it.

Seplow: In the course of our analysis we've looked at a number of different alternative modes of investment or involvement in the pipeline financing plan on the part of the State of Alaska, most particularly, we have looked at the possibility of Alaska providing equity to the project, and our tentative view although I would stress that I see little on the horizon to change that view, would be that equity would be an inappropriate vehicle for Alaska in terms of this project, and there are quite a number of reasons for that. When you assess the appropriateness of investment, one of the first things you have to do is evaluate the capacity of the investor to bear risk, then you have to evaluate risk and see whether or not the investor can stand the loss that would result if things don't work out. Now in these terms I think we have to acknowledge that an equity investment is the riskiest part of this project and given the posture of Alaska as a State, and given our understanding of Alaska's financial resources and future prospects, Alaska, we think, would find it very difficult to bear that risk, and it would seem to us to be inappropriate to ask Alaska to bear that risk. Another element of inappropriateness about equity investment is that equity investment has to be made up front. Indeed the financing plan that has been advanced that may even be required by the terms of the Presidential Decision requires that the anticipated equity funds be invested in the project before any debt funds are invested which would require of an equity investor that it have available the cash to put in almost immediately, and as we review the financial position of the State and its projections for the next several years and the other calls upon its resources, that various members of the State Government have in mind and have perhaps even tentatively committed the State to, there just doesn't seem to be any cash up front for that equity investment. Now even if Alaska were to make an equity investment there's some serious question as to whether this would be the most appropriate investment in terms of the kind of return that Alaska could get. After all, investment in this pipeline conditioning plant is investment in a regulated enterprise and as such the upside return potential is distinctly limited indeed over a fine-eyed (?) period of time as that investment is amortized the actual cash flow return declines. In addition to that we carefully analyzed the projected return to the system owners and we find that a major portion of the return appears in the tax benefits that accrue to those owners, and those are tax benefits which Alaska as a public body cannot share, and indeed the presence of Alaska as an equity owner were the owner of a segment of the transportation system might in fact fritter away tax benefits, several tax benefits that would otherwise be usefully employed in attracting capital. In addition, of course, we heard Mr. MacKay say today that apparently the sponsors have lined up the equity, they don't need Alaskan equity, there are concerns that have been expressed not only by Northwest, but people within State Government about the appropriateness of Alaska being both the regulator and taxpayer of this system, and an equity investor in the system.

All in all, it just does not seem that there are sufficient real benefits associated with an equity investment and there seem to be quite a number of drawbacks to an equity investment so we have as I said tentatively but probably approaching conclusively, we see a conclusion that we should recommend against any consideration of equity investment. I might just make one footnote on this equity investment concept, a number of people have suggested that Alaska should own a segment of the system, for example, the conditioning plant, I've heard it frequently said here that Alaska should own the conditioning plant and I think that presupposes that ownership of a segment such as the conditioning plant would vest Alaska with some degree of control over that facility. I think that that's a misleading notion because I do not think any of the other parties to this project, either the producers or the sponsors, the pipeline companies, or the banks that will be supplying funds are prepared to see an independent party operate a segment of the plant in a way that is not consistent with the overall purpose of that plant, of the entire system, and indeed that was the theory underlining the whole waiver provision with respect to including the conditioning plant in the transportation system. The need to join the conditioning plant to the pipeline in order to create a satisfactory financing base, so I think the illusion that there would be some opportunity to exercise control through ownership is one that probably should be dispelled.

Now, another consideration that we gave to another mode of financing on the part of Alaska that we considered was the possibility of Alaska providing debt. And this is certainly a more acceptable approach in our view than equity, but still comes up with a number of drawbacks. The principal drawback is that again debt financing has to be funded early on, and some of the same considerations that I mentioned before about funding equity and the problems of finding room within the State's current and future budgets as projected particularly in light of spending limitations which may be enacted by the voters really make it very difficult to find a place where the State is going to come up with the cash to fund debt in the next several years when the debt would have to be funded in order to provide a source of funds for construction.

Another consideration about debt financing is as has been alluded to earlier. If the completion risk can be covered by credit-worthy parties, the world capital markets appear to be adequate to meet the debt financing needs of the project, so in terms of making a contribution to the project coming together and getting done, Alaska's participation while it might be useful is not a terribly critical thing in order to increase that probability of ANGTS becoming a reality. What really seems to be needed and which also seems to fit in best with Alaska's capability and risk-bearing position, would be to call upon Alaska to provide some of that contingent commitment supporting completion of the pipeline, supporting the debt funds that would be contributed towards construction. As has previously been discussed when the banks last summer looked at the project they said that they would need credit-worthy parties backing up the debt that they supply with respect to construction and completion issue, we've already heard that the producers and sponsors are making determinations, to some

extent have made determinations as to the amount of credit they can provide to support that completion problem, there are some questions as to whether or not the producers and sponsors collectively will be able to pool enough credit to meet the bank's requirements, there is a risk that the project may fall short in that respect there is a possibility of a so-called gap in terms of that credit support and we think that the most critical need on the part of the project in terms of this financing plan is to fill that gap and Alaska seems to be particularly well suited to do that if Alaska is to do anything. Although the completion risk is the most risky part of the project perhaps there are ways in which to minimize that completion risk with respect to any particular party backstopping that risk, and a principal way of doing that is to what we call backload the responsibility, and essentially what that means is, that any funds that any commitments Alaska would make which would be designed to support the infusion of debt into the project, would be invested at a later stage of construction, toward the back end of construction at a point in time when it would be far easier than it is now to assess the problems that may have arisen that may arise in the course of construction and to assess what funds are necessary to achieve completion, and if the debt funds that Alaska backstops, investment of those funds are conditioned upon, assurances that those funds plus other funds that are available, are sufficient to provide completion, that risk is very significantly reduced. Now one of the other important benefits of this approach is that this approach requires a minimal up front cash commitment by Alaska, and consequently it provides a minimal interference with the State's other investment and expenditure plans. To give you an example of how this might work, if Alaska backed up, provided a back up to debt funds which were only required to be invested after the equity in the project had been expended, and after a debt funds backed up by the producers and sponsors, the funds that Alaska would be backing up would probably not be called upon until fiscal year 1985, at a point in time when a projected three-quarters of the cost of construction would have been expended, and as I indicated before, Alaska-backed funds would then be invested only after receipt of assurances that sufficient funds were provided by the system owners to complete and that the gas would be marketable. Of course once completion has been accomplished the State would have no further liability on its credit backup. Now we've been assured that if Alaska entertained this type of commitment that Alaska would receive a market rate type of compensation for its commitment and that presumably that compensation could either be paid in a lump sum or over a period of time, it presumably could be negotiated either in a fixed amount or in a variable amount depending on the inflation rate in the future, or could it could be pegged to the equity earnings of the sponsors in the project. There are a great number of alternatives as to how that could be designed.

Fundamentally, as we have indicated, we think that this approach does the most for getting the project done, and yet places a minimal risk on Alaska and a minimal call on its current funds. There has been some discussion and Commissioner Katz testified earlier about the approach that Alaska ought to take at this time. We recognize that the details of the sponsors' financial plan will not be available until probably the spring of this year which is really out of sync with the consideration

that this legislative session can address that plan. Now the State could wait until the sponsors develop all of the details of the plan but in view of the fact that the legislature will be going out of session the State will not really be in a very effective position to deal with that after it goes out of session. Consequently we would suggest that if something positive is to be done that there be some sort of expression of support in general for the concept that we are recommending enacted by the legislature or otherwise developed by the legislature and the executive body of the State, and this would perhaps be in a form of a resolution expressing general support for this concept attaching conditions to Alaska's participation and such conditions might include satisfactory assessment by Alaska of all of the risks including the cost and completion risks, and marketability as well as the satisfactory structuring of the commitment to minimize the specific risk on Alaska's part, number two, assurance that an adequate compensation of the, provided for Alaska for undertaking these risks, number three, that there be adequate assurances associated with the problem of Alaska's interest in the wellhead value of the gas. Another condition might be an adequate resolution from the State's point of view of the issue of compensation to the State for the socioeconomic costs of the project, certainly a condition would be that all of the other elements of the financing plan including commitments from other responsible sources be provided. Now this approach would, as my colleague has said, by expressing the support of the State for the project and giving some tangible evidence of that support and being prepared, evidencing the State's willingness to sit down and negotiate details of this participation, would certainly enhance the chances of the project coming together and the other financial participants coming forward with the necessary commitments. It certainly would indicate that this project has a very welcome environment here in the State of Alaska and it certainly indicates that things would be, would be further evidence that things are falling in place in terms of the consummation of this plan.

Moreover, by taking this step I think Alaska would really be gaining a seat at the negotiating table concerning the financing. I mean Alaska's involved in that but in a sense as a partial outsider, and by stepping up and saying we're interested in participating Alaska would gain an opportunity to sit down with all of the other serious participants in the financing plan and have a say about all of the elements in the financing plan, including those elements associated with marketability, whatever arrangements are made with respect to levelizing and that would be an important means by which Alaska could protect its interest in the wellhead value.

Now I want to conclude by saying that the remarks we've made are still tentative, and we've got to sit down and digest some additional information that we've gathered during our visit to Juneau, we've got to put this all on paper for consideration of the task force and public, we are still a little general in some of the concepts that we're talking about, specifically some of the legal elements associated with the implementation of this suggestion have yet to be worked out in detail, but work is continuing and this is a very high order of priority personally and on the part of our firm, and we hope to be back up

here in a couple weeks with our written report and to again submit ourselves to detailed questioning concerning our recommendations.

Q. Thank you. Any questions to same?

Q. Are you ... (garble) and I do have some questions. Let me see if I can ... see if I can just summarize this in layman's terms, what you're saying to us is that the examined equity debt, some kind of contingency ... and that you feel that equity is inappropriate because of the three or four reasons that you set aside, the debt might be more appropriate that it's really not critical in terms of the entire financing, if that's all we're going to get involved with because of the posture of the worldwide price of ... for the financing, and so you're asking us, I say you're asking us, the idea is for us to consider contingency commitments, something that's at the tail end, we probably wouldn't know what that would be until halfway, ... or later, I'm assuming when you say halfways (?) five year, still using 1986 schedule that Northwest has at this time, so could and probably would be later than 1985, fiscal year 1985, is that correct?

Seplow: That's correct.

Q. So we really wouldn't know the dollar amounts that we might be asked to consider until that time. Is that correct?

Seplow: No, perhaps I didn't make that clear. We would be talking about Alaska either currently or within the next year, making a firm commitment to support a credit debt up to a maximum dollar amount, what you wouldn't know about until 1985, 1986, or conceivably 1987, is whether that commitment will be called upon,

Q.: Or even if it's enough?

Seplow: Well, if it isn't enough and if at the time that commitment, the debt funds which that commitment is backing up, is apparently not enough then the debt funds would not have to be invested, Alaska would be taken off the hook until the sponsors and producers could come up with additional funds that would assure that all those funds together would be sufficient to complete.

Cotton: That's about the same question I had on the completion guarantee--I wanted to know if there was a specific amount that we have to lay out here and by tying it to whether or not the producers or others could come up with whatever the additional required funds were, that would significantly lower the risk to the State as far as its participation, is that correct?

Seplow: That's right.

Cotton: That's sort of the idea, and let me make sure I understood the marching orders that ... (gap)

Seplow (?): we think was referred to earlier includes more than those assets,

Cotton: So they would have to make the same assumptions about whichever portion of the project that you were talking about, wouldn't you?

Seplow: That's true.

Seplow: And that the Canadian sections is another part of it, and the prebill, that the part we have focused on because of our assignment for the State is the Alaskan segment not all the rest of it.

Cotton: Okay, I didn't mean to get lost, go ahead.

Seplow: There's one other point that I'd like to make, and that is, if the State were to adopt the approach that we've suggested, which is that it provide a contingent credit backup, the State would not be putting any funds out so the State would not be earning any funds, a interest rate, because the funds are not invested. What the State would be getting is some sort of compensation for having assumed that risk, and that would obviously be largely a function of the assessment of that risk, and it might be impacted by what overall interest rates were.

Cotton: ... once they finally made the call on these funds if in fact they made a call on them, .. point of guaranteeing that they'll be there is because they need them, right?

Seplow: Right.

Cotton: If they didn't need them that would become part of the debt?

Seplow: It's not there in case they need them, it's there to, those funds are going to be put up by perhaps the same group buying some insurance companies that are going to put up the funds that are guaranteed by the credits of the producers and the pipeline companies, it's just going to have a different credit, it's going to have the State's credit instead of Northwest Energy's credit. If the pipeline for some reason is not completed then the providers of the debt capital are not paid their interest and principal repayments on time, then they will call their obligations, they will come to the State of Alaska and say you owe us X dollars depending on the strategy ... (garble) will go to the producers and the pipeline companies ... saying call that they have because they guaranteed the securities so there will be no monies put out by the State of Alaska other than those funds which they might segregate to support their guarantee if it ever got called, whether you have to put up dollar for dollar that amount, make some provision that you put up some monies in overtime that's invested such that gets the guarantees called in some future point in time there'll be enough there to pay the guarantee off. There are all kinds of mechanisms which we haven't worked out yet to support the guarantee.

Cotton: Okay, I was wondering, let me get back out here and let somebody else have some questions. I want to make sure you understand that our, I understand what your position is, you're working for the State and we're paying you to give us advice so I'm

not trying to interrogate you I'm trying to understand, there's a lot of new things here that I'm not that familiar with. I assume you don't also represent any of the pipeline companies or the gas producers, is that correct?

Seplow: Right. Unfortunately that's correct.

(Much laughter).

Cotton: Thank you.

Q.: Following that one step further because I think Representative Cotton opened up something that I was interested in, you mentioned that the State's guarantee comes on last, the question is, if you get a call of obligations, is that call also satisfied last, in other words, if you're talking so many billion dollars that are supported by the pipeline companies as well as the producers and you finally get down to the State's call, is that negotiated to be or recommended to be also the last call in that order as well?

Seplow: It probably would work out so that the call occurs simultaneously, there's probably an outside date by which the project is supposed to be completed, and that date may very well tie in with the FERC set date for when the prebill period commences, and there would be institutions who would be looking to be repaid the debt that they have provided to the project, by that date if it hasn't been completed by that date, and some of those institutions would be looking to Alaska and some of them would be looking to Exxon, some of them to Sohio, some of them to Arco, and some to the pipeline companies, but that would all happen probably simultaneously, now if the project is not completed and we're talking about worst case, by that outside date then each of the credit supported parties would have to step up and pay off that debt, and they would in effect be purchasing that debt and so Alaska would step into the shoes of some of the senior lenders who have a first lien on the project, and they would be Alaska's interest but at that point in time would be senior in claim to the pipeline, to the equity that the sponsors and producing companies have put in, and at that point in time, Alaska and the other holders of the debt would have to worry about what it would take to get the pipeline completed and where those sponsors going to come from, and in the first place, they probably look to the producers and sponsors who have all that equity invested to see if they could provide additional funds. They would have a very powerful motivation for doing that but they wouldn't be legally obliged to do that, now if for some reason they felt that the project had receded in economic viability to the point that they didn't want to put any more money in underneath the first lienholders, then the holders of that debt would have to worry about attracting senior debt, that giving up some of their senior position in order to get enough funds in to complete the project, and you have to go through a rather horrendous litany of events whereby Alaska ended up not only losing some of its money or it really have to go to extremes to come up with a conjured up case whereby Alaska lost all of its money, but Alaska would fill the gap that in terms of taking that kind of credit risk which apparently the banks at this juncture are not prepared to

take except for very small portion of the funds, and I think that the view is that Alaska would probably take, that the banks may take the last few dollars' risk if Alaska would take the dollars before the banks. So basically, before Alaska does anything the project's sponsors and the producers are on the line for three-fourths of the total, again before the State of Alaska loses anything the sponsors and producers have already lost all of their equity share. They've lost the equity share and they've come in for a debt share representing let's say half of the cost of the project, which may equally on one with Alaska. The benefit of that approach is that it maximizes private sector participation prior to public sector participation, it is intended to be a private project as Mr MacKay mentioned, that's the way they want to approach it and this plan fits very nicely with their desire to keep it a private project.

Q.: Representative Cotton.

Cotton: The question I get asked is ... why don't we build an all Alaskan gasline. I know that every bit of advice we've ever got said that it is not feasible and you've made a statement similar to that that suggests that the existing Northwest design is the most and probably the only viable system for this decade. Is that included in a report some place, I usually say that too, but I want to be able to prove it I guess.

Seplow: Can I, maybe we shouldn't be as categorical as we've been making that statement but frankly, the concept of an all Alaskan line is very appealing to me six year ago but a lot of water is gone over the dam in six years. We've had at least three significant problems arisen that may get virtually impossible to conceive of an All Alaskan pipeline in this decade. First of all you've had El Paso which was the sponsor of that project withdraw from the LNG business with terrible financial bruises, they have written off something like half of the corporate equity as a result of losses that they have sustained in the LNG business, and maybe those losses have nothing to do with the kind of risk that they would be exposed to in Alaska, but basically they are out of business in LNG now. Second of all, you've had an inability to get a regasification facility site on the West Coast of United States, they've been working on that for probably ten years, or a good part of ten years and it still hasn't come to fruition, and thirdly, one of the great attractions of the El Paso LNG project was that you could use Title XI US Government shift financing bonds to back up a lot of the credit, well that program has been diminished as a result of the Reagan Administration fiscal constraints and as a result of some poor experiences that the Maritime Administration has had with LNG in other projects, they are not about to give any of their now very scarce guarantee authority to an LNG project of this order of magnitude, so I just cannot see how a project can come to ... even apart from a long lead time that any such project has.

Cotton: So in addition to other things that Ronald Reagan, is because of ... has not been able to consider that all Alaska line.

Seplow: That's only one of three causes.

Cotton: Thank you.

Q.: Are we going to turn this into a partisan discussion?

Cotton: Sure.

Q. Any further questions.

Q.: Mr. Chairman, just so that I understand about three hours ago I think, I think it was pointed out that you would be back in March?

Seplow: Yes, when we complete our report we will submit it in writing and then at the convenience of the committee and legislature, we'll be back up to discuss it.

Q.: Thank you.

Fahrenkamp: I would just like to thank the gentlemen, I know it was a little time-consuming on your part ... to give an interim report before you felt you were ready to go with that, and we really appreciate your taking the time to do it.

Q. Just one last shot I don't know if it was asked while I had to break for another meeting, to what extent have you gone into deregulation of natural gas as far as it affects marketability?

Seplow: We certainly looked at the question and I want to emphasize that we are not the ultimate authority on marketability. We have read the Jensen Associates report that Northwest submitted and we've looked at a number of other sources on that issue and we think it has an impact on marketability. However you slice it you can make a good case for marketability, but you can't make an absolutely conclusive case for marketability without some mechanism which backend loads the gas, the transportation and or wellhead cost. It would appear to us that that is a very critical element in terms of assuring the marketability of the gas and one of the advantages of the approach that we've taken as I indicated earlier is that by Alaska stepping up to, as a negotiator about the financing plan, Alaska would have an opportunity to have a first hand impact on those arrangements.

Q.: That will be part of your final report?

Seplow: Yes.

Q.: Just as you went by that you said backend loads, the transportation and the wellhead cost, of course when I think of the wellhead costs I think of the wellhead costs of the State's share as well, and backend loading there and what the effect might be I just, I'd like to hear more about that and get the,

Seplow: Well, I mean, certainly the wellhead could possibly be backend loaded and that might not be a disadvantageous thing for Alaska and for the producers provided that they were compensated for the ... of both in terms of the time value of the money they are foregoing and in

terms of additional risk that they are incurring by waiting longer for the payment.

Q.: Thank you.

END.

Alaska State Legislature

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Senate

Committee on Resources

Joint Meeting of

The Senate Resources Committee and the House Oil and Gas Committee
The Governor's Task Force on Gas Pipeline Financing
Wednesday, March 31, 1982
Juneau, Alaska
Senate Finance Committee Room

Senate Resources Committee

Senator Betty Fahrenkamp,
Chairman

Senator Fisher
Senator Mulcahy
Senator Bradley
Senator Eliason
Senator Gilman
Senator Sturgulewski

House Oil and Gas Committee

Representative Rick Halford,
Chairman

Representative Bvlsma
Representative Cotten
Representative Montgomery
Representative Randolph
Representative Pogers
Representative Vaska

Agenda

1. Commissioner John Katz - Department of Natural Resources, Chairman of the Governor's Task Force - Overview of Task Force Charge and review of its activities to date.
2. Kenneth Seplow and Otto Lowe - Kidder, Peabody and Company - Presentation of their final report to the Governor's Task Force on Gas Pipeline Financing - Summation of findings and recommendations.
3. Joseph Donohue, Deputy Commissioner of Taxation, Department of Revenue - Overview of state's legal options to financial participation, review of revenue forecasts.
4. Milt Barker - Legislation Finance Division - Review of net economic benefit package.

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ALASKA OPERATIONS
WESTERN DIVISION

R.H. WEAVER
OPERATIONS MANAGER

February 10, 1982

Senator Bettye M. Fahrenkamp
Pouch V
Juneau, Alaska 99811

Dear Senator Fahrenkamp:

We have received with interest your notice of hearing on an interim status report on the Northwest Alaska pipeline project. As we understand the scope of your hearing, the Task Force will be continuing its investigation into the possibility of state involvement in the pipeline project and updating information regarding the status of the financing package for the project.

We have also learned from your staff of your interest in producer response to general questions relating to:

- 1.) where the producers stand on financing of the line
- 2.) the long-range plans for the line
- 3.) the effect of lack of gas production on the Prudhoe Bay reservoir

The first two of these questions do not directly pertain to Exxon's involvement in the ANGTS project as a natural gas producer and we feel that any responses we would have to the Task Force would not be productive to the objectives of the hearing. To briefly respond to your questions as we understood them from your staff:

- 1.) Q. Where the producers stand with regards to financing of the line...

R. As you know, the waivers package signed in December by President Reagan allows the Prudhoe Bay producers to have up to a 30% equity interest in the pipeline and, correspondingly, finance that much of the project. Producer financial participation is defined by law in the waiver package and by the limits committed to as a matter of public record by the individual producers. We have no additional information to provide on the subject.

*Del 2/15/82
10:05 am*

Senator Bettye M. Fahrenkamp
February 10, 1982
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- 2.) Q. The long range plans for the line...
- R. Other than to observe that the question is highly speculative, Exxon, as one of the Prudhoe Bay producers, would not be in a position to respond to questions regarding the operations of the pipeline. We would suggest the gas transmission companies as the appropriate source for a response.
- 3.) Q. The effect of lack of gas production on the Prudhoe Bay reservoir...
- R. We have indicated in the past that the Prudhoe Bay field can be managed so as to produce the reserves with or without gas sales. It has been shown that given the capability for gas injection and waterflood, the same level of ultimate oil recovery can be achieved with appropriate modifications to the reservoir management plan. Further information regarding the question of ultimate recovery of reserves of the Prudhoe Bay field was addressed in some detail by ARCo, Sohio and Exxon at the public hearings May 7 and 8, 1980 held by the Alaska Oil and Gas Conservation Commission for "Conservation File Number 165, Prudhoe Oil Pool."

Please consider our Juneau representative, Mr. Robert J. Walker, at your disposal to further discuss the previous points or to coordinate responses to any other questions you or your staff may develop.

Very truly yours,



R. H. Weaver
Operations Manager

REW/DSE/006/es

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March 17, 1982

Mary Halloran
Special Assistant to
the Commissioner
Department of Natural Resources
State of Alaska
Pouch M, State Capitol
Juneau, Alaska 99811

Dear Mary:

You have asked for an analysis of whether a proposed investment by the State of Alaska in the financing of the Alaska natural gas pipeline might give rise to a "conflict of interest" that would interfere with Alaska's regulatory responsibilities with respect to the ANGTS.

To analyze this issue, we start by examining what legally is a conflict of interest, the State's interests and regulatory responsibilities in the ANGTS, and the relationship between possible forms of State participation in financing the ANGTS and the possibility of conflicting interests.

Legally, what is a conflict of interest varies with the situation. First, there are often statutory restrictions on employees of State regulatory agencies in decisionmaking capacities having a personal interest which conflicts with their regulatory duties. Second, where one is acting as a fiduciary or trustee with respect to the management of particular property, he may be barred from being subject to conflicting loyalties in the discharge of his duties. Third, the term conflict of interest has sometimes been used -- but not in the legal sense, in our judgment -- to describe a situations where a party making a public policy decision on behalf of the State must resolve competing interests in discharging his responsibilities. Thus, there can be situations which are loosely referred to as "conflicts of interest" but which do not fall afoul of any legal prohibition. It is well to bear these differences

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in mind. We believe only the first and third uses of the term could be applied to an Alaskan investment.

Turning to the State's interests with respect to the ANGTS, any serious study of this issue must recognize that the State of Alaska has numerous financial interests in the ANGTS regardless of whether it directly participates in the financing of the ANGTS. The State will receive revenues from severance taxes for gas shipped through the ANGTS and from the use or sale of the State's one-eighth royalty share of North Slope gas production. In addition, the State will receive revenues from property taxes and corporate taxes, and, to a lesser extent, from the various state permits needed for the ANGTS (including the conditioning plant) although these revenues may not cover increased administrative and other costs that the ANGTS may impose on the State. Thus, the State can be said to have a pecuniary stake in the success of the ANGTS regardless of any interest arising from its direct participation in financing. In a certain sense, and in particular circumstances, this pecuniary interest may be opposed to each of the interests described below.

Second, the State, under its police power, regulates production from the Prudhoe Bay field. Historically, the State has exercised its police power to prevent waste of its mineral resources and has premised approval of operating plans on the condition that the plans prevent waste and maximize recovery of hydrocarbons. Conceivably, the State's responsibility to protect the field against waste could conflict with a governmental need for revenue from the field in a particular year. Since the State receives a large percent of its operating budget from petroleum revenues, the conflict could be viewed as particularly acute if the Prudhoe Bay field had to be shut down for conservation reasons. But it is important to note that the State conservation responsibilities are not exercised by a State official subject to other responsibilities but by an independent oil and gas conservation commission whose decisions must be based on the record and are subject to judicial review.

Third, the State must decide whether to issue to the ANGTS a right-of-way lease across State lands for the pipeline, as well as easements across State lands for ancillary construction activities. The Commissioner of Natural Resources, who will issue these leases, could theoretically be faced with a conflict between the desire to

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protect the State's investment (assuming it makes one) and the need to protect the State's lands and receive fair value for the lease thereof.

Fourth, the State controls to a certain extent access to its highways by construction vehicles. The State's desire to secure and maintain decent highways in Alaska potentially conflicts with the needs of Northwest to construct the project on an expeditious schedule. The State has been pursuing an arrangement with Northwest to obtain compensation in advance for anticipated damage to the highways. Again, a conflict could be said to arise between the State's pocketbook interest in obtaining revenues from the ANGTS and its need to protect the highways.

Fifth, several State statutes relating to environmental protection and health and safety are applicable to any large operation in Alaska, including the ANGTS. Various subordinate State officials are in charge of enforcing these statutes, which may improve restrictions that conflict with the State's monetary interest in the ANGTS.

Sixth, the State has a distinct interest in the Alaskan economy and, in particular, in the direct and indirect economic effects of the ANGTS. A State government interested in economic growth would encourage pipeline activities even at the expense of additional government services and short term disruption. Conversely, a State government not interested in rapid expansion of the Alaskan economy would discourage or be indifferent to the ANGTS. Thus, depending on the philosophy of the State government, the construction of the ANGTS could be said to "conflict" with the philosophy and plans for growth of the State government.

Thus, without regard to an investment by Alaska in financing the pipeline, the State has numerous and competing interests in the ANGTS as well as in any other major energy project in Alaska. Generally, the State is presumed to act impartially and in good faith for the public welfare in resolving these competing interests. The question thus becomes whether Alaska's interest in assisting the financing of the pipeline would create a conflict, or sharpen an existing "conflict" to the extent that the impartiality of individual State officials charged with the resolution of competing interests would be undermined.

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Despite the State's competing interests in encouraging and in regulating certain aspects of the ANGTS, the State does not suffer from a "conflict of interest" in a strict legal sense. The conflict of interest doctrine applies when a State official "who stands to gain or lose personally by a decision either way [participates] in the exercise of judicial functions." Davis, Administrative Law Treatise § 19.6. For example, a conflict of interest would arise if an individual official involved in the decision-making process with respect to environmental regulation of the ANGTS had a pecuniary ownership interest in the ANGTS. When a State, acting as a sovereign, balances competing interests (such as protecting the environment and increasing State revenues) to determine what is best for the general welfare, it is not disqualified because of a "conflict of interest."

In other words, prohibitions against conflicts of interest apply only to individuals who have a personal stake in a decision made in their official capacity, not to a State which has conflicting purposes nor to responsible State officials who are charged with balancing competing State interests in carrying out their official functions.

Alaska's statute on conflicts of interest illustrates this focus on the individual decisionmaker; it speaks only to the need "to discourage public officials from acting upon a private or business interest in the performance of a public duty". Alaska Stat. § 39.50.010. "No public official may use his official position or office for the primary purpose of obtaining financial gain for himself, or his spouse, child, mother, or father, or business with which he is associated or owns stock." Alaska Stat. § 39.50.090. A specific conflict of interest provision applicable to the Alaska Royalty Oil and Gas Development Advisory Board also addresses only the conflicting interests of individual members. "No member of the board may act upon a matter in which his relationship with any person creates a conflict of interest." Alaska Stat. § 38.06.035. These restrictions are the only relevant ones we have found in the Alaska statutes that apply to "conflicts of interest."

An argument could be made that the State appears to have a "personal stake" in the construction and operation of the ANGTS arising from its financial investment in the project. Sometimes legal distinctions have been drawn between proprietary and governmental acts by State government, the former being subject to greater scrutiny. We do

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not think, however, that this argument withstands analysis. The argument would be that, in investing in the ANGTS, Alaska is acting as a private person, not in its sovereign capacity, and that the State's "public" interests would thus conflict with its "private" interests. However, this argument rests on the fallacious assumption that a State can act as a private person to further its private interests. By definition, the State, if acting properly, always acts for the general welfare. The real issue is whether the State's use of taxpayer monies to assist the financing of the ANGTS is a proper investment for the general welfare. If so, then the State is furthering a valid interest such as raising revenues, by investing in the ANGTS, and that interest is no more a "private" interest than the State's interest in collecting taxes from the ANGTS.

Conflicts between two governmental interests, such as the interest in protecting the environment, health and safety, and the interest in safeguarding the investment of public monies, often arise. For example, a government may finance certain low-income housing developments; at the same time, it may set safety and building code standards. Similarly, local governments often own utilities. These conflicts are commonly resolved by a balancing of the various interests. It would be helpful for the State to document the public interest in an investment before proceeding with one so as to avoid charges of conflict, but such documentation would probably occur naturally as part of the process of securing legislative approval.

There are analogies in legal precedent that could be applied here but it is not clear whether they should be applied. One consideration is whether the State wants to appear free from a charge of conflict of interest no matter how that term is defined or only to be free from legal problems. For example, although the State may perform a wide variety of functions to further competing interests without creating a "conflict of interest," the State's decisionmaking process, on regulatory matters which are required to be decided upon a record, should insure impartiality. Under the separation of functions doctrine, "an individual who tries to win for one side should not participate in the judging." Davis, supra at § 18.1. This could be done by isolating those responsible for making the decision from competing responsibilities. Thus, the particular individuals who decide the rate of production for the field should not also be responsible for the State's financial investment in the pipeline. Because of the independent

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status of the Alaska Oil and Gas Conservation Commission, this appears to be only a hypothetical concern.

Other precautions could be developed if the State wants to be super-sensitive to charges of conflict, even if not soundly based. Precautions could be taken to isolate those (below the Governor) responsible for deciding police power enforcement questions from those managing the investment. This would avoid any appearance of an improper conflict of interest. For example, employees in a regulatory capacity should not have off-the-record contacts regarding the performance of their duties with, or be supervised by, employees having responsibility for the investment. Of course, if this type of procedure is followed, the decisionmaker in the regulatory area need not ignore the State's interests in protecting its investment; he must simply ensure that input from the investment section is placed on-the-record. This would be a relatively extreme precaution and would come at the cost of straightjacketing your administrative process, perhaps unnecessarily.

Of course, if the Governor were finally called upon to resolve these conflicting interests, he would not be subject to the separation of functions rule. His responsibility would be to consider all competing interests, balance them against each other, and reach the decision that he thought would best further the general welfare. Other cabinet level officers may be in a similar position.

We do not believe any form of State participation in financing is per se objectionable. Each form, as illustrated below, can give rise to "conflict" issues but legally objectionable conflicts do not appear likely to occur and other "conflicts" can be addressed as suggested above if the State deems it necessary. If the State provides a loan guaranty for completion of construction which limits its financial interest to the construction period, the State would not have any investment interest after construction which might conflict with any governmental relationship it might subsequently have with respect to the ANGTS, such as later taxing or conservation regulations. But this form of participation does not prevent all "conflict" problems. Many of the State's governmental relationships with the ANGTS will be strongest during construction since the State decisions that must be made during this period (environmental protection requirements, rights-of-way leases, etc.) could affect the schedule, cost and financing of the ANGTS. And, these decisions, in turn, might affect whether a guaranty would be called upon.

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Nor does choosing debt instead of equity for the State's investment automatically avoid problems. The indentures under which debt is issued typically carry restrictions on how the enterprise is managed and, ultimately, the right to take over the enterprise if it is managed badly. Equity, at least initially, provides for a direct vote in the management of the enterprise but whether that vote is meaningful depends upon the voting power held and the corporate charter or partnership agreement. Thus, it is not clear that a debt rather than an equity investment is to be preferred as per se avoiding conflict questions.

In sum, when and if the State decides to invest, the State may wish to consider whether to establish special arrangements for insulating regulatory officials who will decide issues relating to the ANGTS. On the other hand, we believe that the State's participation in the financing of the ANGTS in any of the ways that have been seriously put forward would not give rise to a conflict of interest that would legally bar an investment in the ANGTS. Assuming that the investment meets the standards for expenditure of public funds, it should also satisfy the public purpose doctrine for conflict of interest questions.

Sincerely yours,



Robert H. Loeffler

RHL:c

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March 2, 1982

Mary Halloran
Special Assistant to
the Commissioner
Department of Natural Resources
State of Alaska
Pouch M, State Capitol
Juneau, Alaska 99811

Dear Mary:

This is in response to your request for our opinion as to the likelihood of the Alaska Natural Gas Transportation System ("ANGTS") meeting its announced in-service date of the winter heating season of 1986-1987 in view of the current status of proceedings related to the ANGTS at the FERC.

We begin on the premise that predictions of this kind are fraught with uncertainty because they depend on the number of events beyond the control of the FERC, most notably the submission of a financing plan after some form of financing agreement has been reached among the parties and with the financial community. Even when events are within FERC's control, it almost never meets its announced schedule and this is especially true when matters are controversial, complex, or important. From a historical perspective, one must remember that the President's Decision contemplated that the ANGTS would be in service this past fall. Thus, announcements of firm schedules must be viewed with a certain degree of skepticism.

The ground rules are clear. ANGTS must receive a final certificate of public convenience and necessity from FERC. It is a basic premise of large project financing that all major permits and authorizations must be secured before financing is completed and, in most cases, arranged. Further, judicial review of the permits must be completed. Finally, no substantial construction can begin before financing is obtained.

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The degree of detail in a financing plan necessary to secure a certificate from the Commission is less than clear. The Commission could approve a "conceptual" financing plan for ANGTS and give Northwest a definite time period after issuance of the final certificate to make a compliance filing indicating that financing had been arranged in accordance with the terms of the conceptual plan. This could be accomplished by attaching a condition subsequent to the certificate of public convenience and necessity requiring Northwest to file its actual financing arrangements with the Commission six months after issuance of the final certificate of public convenience and necessity. Further, the lending institutions would want to be sure that judicial review will not upset the Commission's action issuing a certificate, so one must allow a period of a maximum of 150 days from the issuance of the final certificate before judicial review would be concluded (i.e., 60 days to bring the action; 90 days for the court to hear and decide the case).

With these rules in mind, let me turn to what is before the Commission. The proceedings currently pending before the FERC include:

1. The final certification proceeding for the Alaska segment.
2. Production related costs rulemaking for Prudhoe Bay gas.
3. The Alaska segment cost estimate proceeding.
4. Rate base proceedings for Alaska segment and Northern Border pre-1980 costs.
5. The Northwest Canadian Gas Sales Company certificate and import applications in lieu of Northwest Alaskan Pipeline Company.

Others to be instituted include:

6. Rulemaking on shipper tracking of ANGTS transportation charges.
7. In the more distant future, final certification of the non-prebuilt sections of Northern Border and Western Leg, and certification of shippers of Alaska gas.

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Mary Halloran

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It is noteworthy that the cost estimate proceeding (CCE) (number 3 above) has been going on for nearly 2 years and should be nearing its end. Nonetheless, just on the few issues that Alaska is pursuing in the CCE proceeding, the record will not close and briefs will not be filed before the beginning of April. Beyond that, when the Alaska Gas Office and Federal Inspector's Office finish their report on the cost estimate, by Commission order there will be a comment period of 45 days (30 days for comments and 15 days for reply comments) before the Commissioners take up the subject. Thus, unless the Commission drastically changes the procedure in the critical cost estimate proceeding, the Commission is unlikely to finish its work just on this one matter before late June or July at the earliest. As you know, the cost estimate is the foundation for the application of the incentive rate of return formula. The cost estimate also could affect the financing efforts if the FERC reduces the estimate excessively or is critical of the engineering behind the estimate.

There are other major issues to be addressed by the FERC. According to testimony presented by the Chairman of the FERC to the Senate Energy Committee during its hearings on the Senate waiver package, such issues include:

1. The financing plan, including tariff issues.
2. Cost of service of ANGTS and its net national economic benefit.
3. Marketability of the gas.
4. Cost allocation between gas and liquids for the conditioning plant.
5. Any remaining design questions.
6. Any issues deferred from the Alaska segment cost estimate proceeding.

What the Chairman did not list was another critical proceeding: the setting of the target completion date for purposes of the billing commencement provisions of the waiver package. This date will be the trigger by which the billing commencement provision kicks-in and could generate much controversy from consumer groups and consumer-minded state utility commissions. Also, antitrust review by the Department of Justice on producer equity ownership must

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occur and FERC then must approve the form of producer equity participation.

Based on my experience with the FERC, both generally and with respect to the processing of the ANGTS applications, it is highly unlikely that work could be completed on these issues before early fall. In addition, the FERC trial staff has indicated that it will take an aggressive posture with respect to these issues and that it will seek to raise other complicated issues, most notably those raised by the Report of the House Committee on Energy and Commerce. If so, the proceedings could take considerably longer.

The one bright spot is that the Commission has designated Commissioner Sousa to preside over a technical conference on March 16 where the timing of the project and the status of the financing and other issues will be addressed. A more definitive indication of the timing of the project either from the sponsors or from the Commission may emerge at this conference.

How does this FERC schedule relate to the announced completion date of the ANGTS? At technical conferences at the FERC, representatives of Northwest Alaska said that to permit completion of the project by the winter heating season of 1986-87, major commitments with respect to procurement for the conditioning plant had to be made by May of this year. The May date was arrived at by backing off from the time when those items must be on the North Slope the lead time for procurement and the number of barge seasons necessary to ship those items by barge to Prudhoe Bay. May is slightly more than two months away and as of this date, certain substantial elements of the Northwest application are missing. Most notably these include the financing plan, pro forma cost of service, net national economic benefits study, marketability study, and gas contracts.

Given the work that must be completed at the FERC, if the timing considerations relating to May commitments that have been announced by Northwest cannot be altered, it is my judgment that it is nearly impossible for the project to adhere to an in-service date of 1986-1987. Thus, a 1987-88 schedule becomes the earliest likely schedule. The March conference may give us further guidance.

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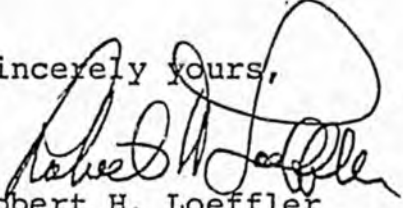
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If you have any questions with respect to this matter, please let me know.

Sincerely yours,



Robert H. Loeffler

RHL:c

cc: Kenneth F. Seplow
Kidder, Peabody & Co.