11981 SENATE RESOURCES

Organization	Submitted by	Submission #	Code
Doyon, Limited	Mery, James	1675	RSC_RSK_01
Fairbanks North Star Borough	Whitaker, Jim	0985	AGPA_01 CNSTL_04 FIF_02 OWNRISK_02 WORK_COMM_01
Haines Borough	Venables, J. Robert	1697	OFFTAKE_01
Haines Chamber of Commerce	Haines Chamber of Commerce	2166	AKHIRE_23 COMM_08 IMP_S_02 INFRA_04 OFFTAKE_01
Hawk Consultants	Tapp, Maynard	0705	AGPA_02 FIF_01 GENBEN_01 GENBEN_02 GENBEN_05 GENBEN_07
Ketchikan Gateway Borough and City of Saxman	Williams, Joe	0099	EDI_06 GENBEN_04 OFFTAKE_01 OTA_01

Organization	Submitted by	Submission #	Code
Municipal Advisory Group	Municipal Advisory Group	2112	LCL_X_18
Municipal Advisory Group	Municipal Advisory Group	2113	LCL_X_18
Municipal Advisory Group	Municipal Advisory Group	2114	IMP_S_06
Municipal Advisory Group	Municipal Advisory Group	2115	AKHIRE_21
Municipal Advisory Group	Municipal Advisory Group	2159	IMP_S_07
Municipal Advisory Group	Municipal Advisory Group	2160	IMP_S_05 OFFTAKE_01
Municipal Advisory Group	Municipal Advisory Group	2161	LCL_X_17
Municipal Advisory Group	Municipal Advisory Group	2162	LCL_X_07
Municipal Advisory Group	Municipal Advisory Group	2163	LCL_X_19
Municipal Advisory Group	Municipal Advisory Group	2164	LEGIS_03 LEGIS_07
NANA Worksafe	Fagnani, Matthew	0843	FIF_01 FISC_01 GENBEN_02 INCNT_01 PPT_01
North Slope Borough	Itta, Edward S.	1695	AKHIRE_16 DISP_01 ENVR_11 ENVR_12 ENVR_13 LCL_X_09 LCL_X_10 LCL_X_11 LCL_X_12 LCL_X_13 LCL_X_14 LCL_X_15 LCL_X_16 LCL_X_17 PPT_07 UUFC_01 WORK_COMM_07

Organization	Submitted by	Submission #	Code
Northrim Bank	Langland, Marc	0467	FIF_01 GENBEN_01 GENBEN_02 GENBEN_05 LLC_05 MRKT_03 PFD_04 PPT_01 PPT_03 TIME_01
Resource Development Council	Owens, Tadd	2167	ACC_02 OWNRISK_02 RCA_01 UUFC_02
Shell Energy Resources Company	Odum, Marvin	1673	ACC_01 ACC_02 ACC_04 ACC_07 ACC_12 FERC_01 FERC_02 FERC_04 RCA_01
Tanacross Incorporated	Brean, Robert	1640	AK_NATV_03 AK_NATV_04 AKHIRE_01 AKHIRE_17 AKHIRE_18 AKHIRE_19 AKHIRE_20 IMP_S_02 IMP_S_03 IMP_S_04 INDST_02 OFFTAKE_01 SGDA_01 SUBST_02

Organization	Submitted by	Submission #	Code
Tesoro	Burden, Gene	1685	ACC_03 ACC_16 AK_DMD_01 FERC_01 FERC_04 FERC_05 OFFTAKE_01 RCA_01 RCA_02 REGCON_01
Tongass Conservation Society	Vickery, Gregory	0096	ACC_11 AK_DMD_01 AKHIRE_04 AKHIRE_05 CNSTL_01 CNSTL_03 CNSTL_07 DISP_01 LCL_X_01 LCL_X_04 OTA_02 OVRRUN_01 PFD_03 RCA_01 STRND_01 WORK_COMM_01
TransCanada	McConaghy, Dennis	1212	CAN_OWN_01 CAN_OWN_02 CAN_OWN_03 CAN_OWN_04 CAN_OWN_05 CANREG_03 CANREG_04
TransCanada	Kvisle, Hal	1213	CAN_OWN_01 CAN_OWN_02 CAN_OWN_03 CAN_OWN_04 CAN_OWN_05 CANREG_03 CANREG_04

Organization	Submitted by	Submission #	Code
Udelhoven Companies	Udelhoven, James	0835	FIF_01 OVRRUN_03 WORK_COMM_02
VECO Alaska, Inc.	Maloney, Tom	0834	AKHIRE_14 FIF_01 GENBEN_01 GENBEN_05 MRKT_03 SGDA_02

Part 3

Index of All Submissions from Legislators or Their Consultants

This index lists submissions from legislators or their consultants. The index is sorted alphabetically, and shows the submitter's name, the submission number and the SOCs to which the submission was coded. To find the state's responses to the concerns in a particular submission, look up the submission by the submitter's name in the appropriate index, note the SOCs to which the submission was coded, then look up the state's response to the SOCs in Chapter 3 of the Summary of Public Comments.

Submissions - Alaska Legislature and Legislative Consultants

To see the response to a submission, find the name of the legislator or legislative consultant in the alphabetical index and note the Statement of Concern (SOC) code(s) assigned to it. Next, turn to the Response to Comments section to read the definition of the SOC and the response to the concern.

Name	Submission #	Code
Barnes, James *Legislative Consultant*	0804	ACK_01 CNSTL_04 CNSTL_10 CNSTL_11 DISP_01 FERC_01 FISC_01 FISC_02 FISC_06 GENBEN_05 INCNT_01 INKIND_01 LLC_02 LLC_04 LLC_07 RCA_01 RCA_02 REGCON_01 SGDA_01 STRND_01 WORK_COMM_01 WORK_COMM_02 WORK_COMM_05 WORK_COMM_09
Ellis, Johnny and Ethan Berkowitz *Alaska State Legislature*	2109	ACC_07 ACC_09 AK_DMD_01 AKHIRE_03 CNSTL_12 DISP_01 FERC_01 FISC_01 FISC_04 FISC_05 FRCE_02 INCNT_08 INKIND_01 LLC_08 LLC_13 NATRSC_11 OTA_02 OWNRISK_04 PTU_08 RSRV_X_01 SGDA_03 SGDA_08 SGDA_09 WORK_COMM_08 WORK_COMM_09

Name	Submission #	Code
Gildan, Phillip C. *Legislative Consultant*	1646	LLC_11
Gildan, Phillip C. *Legislative Consultant*	1647	LLC_09 LLC_14
Gildan, Phillip C. *Legislative Consultant*	1648	LLC_09
Gildan, Phillip C. *Legislative Consultant*	1652	DISP_01
Gildan, Phillip C. *Legislative Consultant*	1653	LLC_11
Gildan, Phillip C. *Legislative Consultant*	1654	LLC_09
Gildan, Phillip C. *Legislative Consultant*	1655	FISC_01 SGDA_06
Guttenberg, David *Alaska State Representative*	1725	AKHIRE_03 CANREG_01 FIF_02 RCA_01 REGCON_01
Harris, John *Alaska State Representative*	1018	AGPA_01 AKHIRE_03 GENBEN_02 HEARINGS_03 INDST_02 NATRSC_01
Ramras, Jay *Alaska State Representative*	1726	ACC_09 AK_DMD_01 CNSTL_01 FIF_02 INKIND_01 LLC_09 LLC_13 SGDA_14 WORK_COMM_01 WORK_COMM_09
Shepler, Donald and Phillip C. Gildan *Legislative Consultant*	1668	ACC_02 ACC_08 ACC_10 ACC_11 DISP_01 FERC_01 FERC_07 INKIND_01 LLC_11 OTA_01 SGDA_07 SGDA_20

Name	Submission #	Code
Therriault, Gene *Alaska State Senator*	1019	ACC_03 AGPA_01 FERC_02 GENBEN_03 GENBEN_05 MRKT_01 NATRSC_08

Name	Submission #	Code
Therriault, Gene and Ralph Seekins *Alaska State Legislature*	2110	ACC_01 ACC_07 AK_DMD_01 CAN_OWN_01 CANREG_02 CNSTL_01 CNSTL_08 DISP_01 FERC_06 FISC_01 FISC_08 FISC_09 FISC_10 FRCE_02 INKIND_01 LLC_02 LLC_08 LLC_09 LLC_11 LLC_13 OIL_PX_01 PTU_05 PTU_06 RCA_01 SGDA_01 SGDA_14 SGDA_16 SGDA_17 SGDA_18 WORK_COMM_01 WORK_COMM_03 WORK_COMM_06 WORK_COMM_08 WORK_COMM_09

Name	Submission #	Code	Name	Submission #	Code
Wagoner, Thomas H.	2111	ACC_01			
Alaska State Senator		AK_FINC_01			
		CNSTL_01			
		CNSTL_06			
		CNSTL_08			
		LLC_11			
		OWNRISK_02			
		OWNRISK_04			

Attachment 2:

State's Official Responses to Selected Comments

Contents

During the course of the Public Comment Process, the State chose to respond individually to several comments. This attachment contains the state's official responses to these selected comments. It should be noted that all of the comments listed below were also included in the public comment database. It is also important to note that these responses were written over the course the public comment and legislative process during which several key events transpired, and therefore the content must be understood in the context and timing in which they were written. To that end the responses are presented in chronological order. Finally, it should be noted that several of the responses have been edited from the originals for typographical and grammatical errors. Where words have been added or changed they are shown in brackets [*].

Backbone II Response

June 2, 2006

This is the State's point by point response to the Backbone II's May 19, 2006 "Preliminary Analysis of the Proposed Natural Gas Pipeline Contract."

There are numerous analytical errors in Backbone II's preliminary analysis, which are addressed and corrected in this document.

Backbone II's purpose in preparing its May 19th memorandum seems to be to stop the gas pipeline contract:

> "The first quick analysis of the Governor's proposed gas pipeline contract shows many serious problems, any one of which should disqualify [it] from consideration" (Backbone II May 19, 2006 memorandum at page 1)

Moreover, the Backbone II memorandum resorts to the use of fear, hyperbole and mistruth to influence the reader to be against the gas pipeline contract:

> "The proposal gives most of the profits to the oil companies while the State takes much more than its share of risk, including the possibility of exposing the Permanent Fund. (Backbone II May 19, 2006 memorandum at page 1)

Because the contract is the result of give and take negotiations with the State agreeing to items important to the Producers in exchange for items important to the State, we request that the reader consider the contract as a whole. Will it reasonably progress the gas pipeline project without unreasonable risk to the State? Will the rewards received by the State outweigh the risks? Is there a viable, better alternative? We are seeking a thoughtful discussion on the merits to answer these questions.

We urge the reader to seek additional information to that contained here.

Our website address is: http://www.gov.state.ak.us/gasline/

1. The contract is in conflict with the current legal definition of "Stranded Gas."

Backbone II contends that the contract conflicts with the current legal definition of "Stranded Gas" and the "only way to prove the gas is stranded is to open up sufficient gas purchases to free market forces and to have somebody show up."

The suggestion that the gas should somehow be "opened up to free market forces" makes no sense. The large North Slope producers have property rights in their gas leases. Does Backbone seriously contend that the State can auction off gas held by leaseholders with whom the State has executed valid leases? Or should the State attempt to revoke the leases, thereby provoking years of litigation over the billions of dollars of value that those leases represent? Why does Backbone II think those leases would go to its client given the obligation under Alaska law to place such leases out to bid? In any event, the object of the SGDA was to find the surest way, given prevailing conditions, to move the gas to market, thereby monetizing our gas. The Administration's choice, after weighing the circumstances and the options of competing projects, was to negotiate a contract with those who have the gas because that was the most expeditious way to secure a gas pipeline.

Over the last 30 years other projects with lower costs, lower risks, higher rates of return or other attributes have been developed while Alaskan natural gas has not. In fact, natural gas production worldwide has more than doubled from 97.2 billion cubic feet per day in 1970 to 258.8 billion cubic feet per day in 2005. The average growth rate was 4.9% per year. Thus, other natural gas projects [likely less expensive] have been developed, while Alaskan natural gas has not.

The Governor has acknowledged that today's price forecasts are encouraging to the project. However, both he and the Commissioner of Revenue recognize that increased gas prices also increase the viability of competing international projects. The Alaska Gas Pipeline Project must be enhanced to make it more competitive.

As contemplated by the Stranded Gas Development Act, the Commissioner of Revenue in his "Preliminary Findings and Determination of the Commissioner" using the above information and other analysis "has determined that ANS gas is stranded for purposes of the SGDA." FIF Section 9.2.1 at 242; see also Section 1.4.3 at FIF 24-25. The economic analysis that supports his conclusion is contained in Appendix C.

That analysis satisfies the definition in the SGDA.

Backbone II may object to the process followed by the Commissioner of Revenue, but it is the process that the Legislature set out in the SGDA. If the requisite qualifications are met, the Commissioner of Revenue "may develop a contract" (43.82.200) and include within the contract a variety of terms relating to royalty and taxes, among other matters. The Legislature specifically provided for confidentiality to attend to information supplied in the negotiations. Acting within the confines of the SGDA's requirements, the Commissioner also kept key members of the Legislature informed about the progress of the negotiations. Not only were confidential negotiations in keeping with the SGDA, they are the norm for business negotiations.

2. The contract violates Title IX of the Constitution by contracting away the taxing authority of future legislatures.

Backbone II's assertions are not grounded in the language or history of Article IX and relevant federal Contract Clause case law, which collectively make clear that the Alaska Constitution allows a legislature to temporarily contract away its taxing power.

The Attorney General has issued a lengthy and well researched opinion which concludes that the proposed contract is in accordance with sections 1 and 4 of Article IX of the Alaska Constitution. The Administration has acknowledged that this is a case of first impression in Alaska and that it is likely to be litigated.

Also see answer to item 6.

3. **The contract states that "any failure to comply with Article 6 (the Alaska hire provisions), does not constitute a material breach of the contract..."**

Backbone misleadingly quotes only a portion of this sentence of the Alaska hire section of the contract. The full section reads as follows: "Any failure to comply with, or breach of, Article 6 does not constitute a material breach justifying the termination of this Contract." (emphasis added).

A breach of Article 6 does not fall within those circumstances of the parties' agreement to limit the termination penalty to a failure to advance the project with diligence. Article 6.7 does set forth those remedies available to the State for breaches of the Alaska hire provisions.

Termination of the contract under Article 5 is the ultimate contractual penalty the State can seek. It is one that is available only prior to project sanction -- the point at which FERC and NEB have issued certificates and the entity owning the pipeline has given notice that it will proceed with construction. Because the consequences of termination are so severe, the State must demonstrate by "clear and convincing evidence" that the Producers have not acted with "diligence", thereby causing a material adverse impact on the project. The parties have agreed that the termination provision under Article 5 should be a remedy limited to a very narrow set of circumstances as befits a penalty this drastic.

4. **The contract forbids disputes between the State and the participants regarding their obligations under the contract from being adjudicated and requires that they be decided by an appointed "Tribunal".**

The contract does not forbid the adjudication of contract disputes between the State and one or more participants. All disputes under the contract are subject to adjudication; the form of the adjudication is arbitration according to a carefully balanced set of rules modeled on the rules of the International Institute for Conflict Prevention and Resolution ("CPR"). Arbitration is widely utilized in US and international commercial contracts to resolve disputes.

The State has agreed to an arbitration clause in a number of existing contracts and has successfully invoked it—most recently in an action against ExxonMobil.

Back' one II shifts back and forth between the general provisions of the dispute resolution and the special process for termination of the contract under the work commitments clause in a confusing manner. It alleges that the arbitration process is "heavily biased to virtually assure that the producers would prevail in any attempted arbitration." They cite generally the alleged absence of a damage remedy, alle ed unfairness in selecting the arbitrators, and alleged unbalance in discovery rights. They also make an argument that the producers are exempted from arbitration for failure to move the project forward. Their general allegations about the dispute resolution process will be answered first followed by an answer to the issues they raise about termination under the work commitments clause.

Contrary to Backbone's allegation that damages cannot be awarded, Rule C.10 provides that "the Tribunal may grant any remedy or relief, including provisional relief and specific performance, that is within the scope of this Contract and permissible under the Law applicable to the Dispute." Damages are available as part of "any remedy" except in a few limited circumstances.

With regard to arbitration, Backbone is simply wrong in stating that the producers are granted greater rights than the State in selecting arbitrators. Disputes may take the form of a dispute between the State and one company or between the State and more than one company. In each case, the parties to the dispute jointly try first to agree on the arbitrators. At this stage, there is no voting process; the parties discuss who is qualified and seek to agree on the panel. If agreement is not reached within 75 days, then a neutral body, not the parties, provides a list of qualified arbitrators from their standing lists of experienced arbitrators. The producers do not have greater rights than the State at either stage.

After that, each party may strike one candidate. In a single participant dispute, each side gets a single strike from the list. In a multi-participant dispute, each party, whether there are three or

four parties, gets a strike but there is no reason to assume that in all cases the producers will take a unified position. Indeed, in a dispute over the expansion provisions, for example, the State and one producer or even two producers could line up in exercising the right to strike against a third company. Even so, the value of striking a potential arbitrator from the list is quite limited because neither the State nor the companies will have the right to nominate preferred candidates to the neutral list proposed by CPR.

Backbone also misunderstands the discovery provisions. Discovery is scaled according to the size of the dispute. The largest disputes that could arise under the contract would be disputes concerning the payment in lieu of the new PPT. Those disputes are not subject to any pre-set limit on discovery. The Tribunal decides what discovery is appropriate to the circumstances. That is virtually the same standard as courts apply.

The other large disputes that the State has faced in the past such as the disputes about the value of oil or gas for tax or royalty purposes should not arise. The reason is that the State is taking its royalty in kind and receiving tax payments as gas, not cash, accordingly to a pre-arranged formula.

For small disputes -- generally under one half or one million dollars -- there are limits on depositions. This is sensible unless one believes in enfranchising lawyers to litigate disputes at any cost regardless of the size of the dispute. Moreover, in multi-participant disputes, the producers are not given three times the number of depositions as Backbone claims. Rule C.11(b)(iv) (E), says clearly "in a Multi-Participant Dispute, each side to a Dispute is entitled to no less than two (2) oral depositions." So if the State is on one side and all three companies are on the other side, each side, not each party, has equal rights.

Backbone also distorts termination under the work commitments clause. They claim that the producers are exempted from arbitration for such issues as failure to move the project forward because of commercial disputes or regulatory issues.

What Article 5.5 actually says is that in deciding whether to terminate the contract due to the absence of "diligence" the

Arbitration Tribunal shall "take into account" various factors. Taking reasonable facts into account is hardly an exemption from arbitration. Among the factors are the plain and obvious facts that project development may be delayed by US or Canadian regulatory processes. Since construction cannot begin on the gas pipeline without prior approval of the US and Canadian regulators, requiring the Tribunal to take that into account is not a concession but a fact of life.

Finally, Backbone's argument about the burden of proof is equally misguided. The burden of proof is neither the highest -- beyond a reasonable doubt -- nor the lowest -- more likely than not. Given the huge commitments that all parties are making to this giant project, the contract should not be too easily terminated. Rather, if the State feels that termination is warranted, it should be convinced and be convincing. A clear and convincing standard fits that goal.

5. **The contract grants the producers an exclusive right and monopoly to build and operate the gasline, and the ability to prevent anybody else from doing so. Without the risk of forfeiture for nonperformance within mandated timeframes.**

The Governor has followed the direction of the Stranded Gas Act to negotiate a business deal. Because the producers already hold rights to the gas that would support any pipeline and have been willing to negotiate a business deal, pursuing hypothetical alternative projects that have no rights to gas makes no sense.

Moreover, the State has no right to dispose of its royalty gas until it is produced. There are legal theories that, if successfully pursued in litigation, might force relinquishment of leases or the sale of gas. But litigation would take years and any project would be delayed while costly and complex litigation played out in the courts with no certainty of result. Even if the State got back its gas leases through litigation, under current law the State would have to re-bid new leases. There is no assurance that Backbone II's client would get those leases as part of such a re-bid.

The State obtained a bundle of rights in return for the fiscal certainty that the contract provides the Producers. It obtained the right to own a substantial share of the pipeline, it obtained the right to receive production tax payments in gas, not cash. It obtained the right to have the producers ensure that its gas will have proportionate access to capacity to move its gas to market, and it obtained special expansion and other rights. As part of the overall gas pipeline negotiations the State obtained the producers' agreement to increase their taxes on oil by approximately a billion dollars a year.

Finally, only the FERC and NEB have the legal authority to authorize construction and operation of a gas pipeline. Their requirements must be satisfied. Among those requirements are that a pipeline has financing, gas supplies and shippers. The producer project is the project most likely to meet those tests.

6. The contract violates Title VIII of the Constitution requiring maximum development for the maximum benefit of Alaska.

We believe that the proposed contract is consistent with Article VIII's mandate to develop the state's gas for the maximum benefit of Alaska's citizens. The framers recognized that developing Alaska's resources according to the mandate of Article VIII might require an innovative tax regime as reflected by their rejection of a more restrictive version of section 1 of Article IX and instead providing that a legislature may temporarily contact away the taxing power in order to maximize the development of industry in Alaska.

Three key ingredients are required to obtain a gas pipeline contract: fiscal certainty, State equity participation and the State taking gas in kind and committing to ship it on the pipeline. The combination of these three factors significantly improve the project's internal rate of return, thus making it more likely that the gas pipeline project will in fact be built. Moreover, total state oil and gas revenues will be comparable to those the State would have received under the 2005 fiscal regime. Therefore, the State will obtain substantial revenues from a gasline and encourage development of our vast ANS gas resources which will benefit all Alaskans. Moreover, the gas pipeline will result in a twenty year extension of

the TransAlaska Pipeline System. Finally, there will be thousands of construction jobs for which we are training Alaskans to fill. Alaskans will also be able to perform pipeline work in Alberta.

Also see Answer to Item 2.

7. The contract is incomplete.

The contract is complete, although we're still reviewing the Accounting Procedures in Exhibit A and Example Calculations in Exhibit F to ensure they accurately represent the provisions of the contract. The contract that we posted on May 10th included all terms with the exception of the complete integration of the terms associated with PPT. The updated contract posted on May 24th added provisions in Article 11, 20.3, and in Exhibits P, Q, R, X, Y, and Z. No other changes were made to the contract. As the Governor and the Producers announced on May 24th, the parties are prepared to sign the contract released on that date. We have always acknowledged that changes to the SGDA are required before the Legislature can ratify the contract.

The SGDA was enacted in 1998 long before negotiations for a gas line actually began, and certain features of the contract that will benefit Alaskans were simply not anticipated in 1998. We are now in the public comment period in which the contract, proposed legislation and numerous other documents are available together as a package for the public and the legislature to review.

8. The contract prohibits the state from regulating the pipeline.

Legally, the FERC has the exclusive right to authorize the construction and operation of an interstate natural gas pipeline system, specifically the Alaska natural gas pipeline in the United States. In this case, that authority extends to the gas treatment plant and gas transmission pipelines between the producing fields and gas treatment plant. The FERC has already exercised its jurisdiction by extending the open season regulations to the GTP. We also expect that gas transmission pipelines that supply an interstate gas pipeline also will be regulated by the FERC. This is

unlike TAPS in which federal regulation is far less pervasive and there is dual regulation of rates with RCA.

Thus, the RCA is powerless under federal law, not because of the contract to regulate the gas mainline, the GTP or the gas transmission pipelines. If the RCA should attempt to assert jurisdiction where it has none, its actions would interfere with the scheme of federal regulation and would precipitate unnecessary delay and litigation. Article 8.3 of the contract confirms existing law and is designed to avoid regulatory misadventures.

In the totally remote hypothetical case in which the RCA tried to extend its regulatory authority to the project in a way that conflicted with federal principles, the State would seek to cure the conflict. If it failed, the companies could initiate a dispute but recovery in such a dispute would be limited by Article 37.2 (Limitation on Remedies and Damages).

The other Backbone criticisms are truly remote and speculate. For the federal government to turn over regulation of an interstate pipeline to the State, as Backbone suggests, is farfetched. It would require the federal government to exempt one interstate gas pipeline from its comprehensive regulation of all interstate gas pipelines and the one pipeline that would be exempted would be the one with the highest national interest.

The analogy to the RCA's decision on TAPS intrastate rates is inapt also. Legally, the RCA found that the TAPS intrastate rates were too high because the profit component of the rates was far too high. Backbone argues that if a parallel indemnification clause were in effect for TAPS, the State would have had to "eat the difference." Backbone has not carefully read the contract. Article 37.2 precludes an award of lost profits. So, even if the RCA had jurisdiction to determine that the gas pipeline rates were too high, which it does not, the State would not have to "eat the difference" of lost profits.

9. The contract requires the Legislature to enact amendments to bring it into compliance with the law, and only then will the

parties agree to it. The contract is badly out of compliance with current law.

As noted above in our answer to Item #7, we have long acknowledged that changes to the SGDA would be required. In fact, the AG's Response to Commissioner Irwin's memo stated that the potential need for conforming amendments to the SGDA was recognized early on in the negotiation process. Those amendments were presented to the Legislature on May 31, 2006.

10. **The contract contains no start date, no requirement to actually spend the several billion dollars the companies say it will cost to perform the first tasks to design and begin permitting the project much less a commitment to actually build and complete a gas line.**

The contract includes a specific start date for the work to begin, which is 90 days after the effective date of the contract. The contract also requires the Sponsors to diligently implement the Qualified Project Plan from then onwards until Project Sanction. Project Sanction is the date on which the Producers will decide whether or not to build the project. It is not until then that the State and Producers will have completed their design engineering and permitting, and thus know the costs of the Alaska and Canadian portions of the project and the costs associated with FERC's certification. On Project Sanction date the Sponsors must decide whether or not to accept the time table set by FERC and the NEB for completing the project. Therefore, the work commitments under the contract are stronger than anywhere else in the world. The Producers do not have an open ended contract.

In addition, the project sponsors will be providing an annual update of the Project Summary, which is a public document. The major components of that update will include a description of the work accomplished and an updated project schedule. These updates will provide all Alaskans the opportunity to understand the progress that is being made on the project.

Many projects in the world are indeed built with intermediate steps and gates, sanctioned by boards. Typically in other

countries, a project plan is presented **after** the contract has been signed. The decision points of the Alaska Gas Pipeline are clearly laid out in the Qualified Project Plan and were presented and approved **prior to** the effective date of the contract. No major project has contractually required timelines as is claimed by Backbone II.

No investor in the world would agree to a contract in which it was obligated to build the line by some specified date four years prior to having the cost and other information the State and Producers will have at Project Sanction. Four years from now gas prices could be $ 2.50 per mmBtu or the price of steel could have gone up dramatically and the project would be completely uneconomic for any investor—including the State.

The Project includes the Mainline. The Mainline is clearly defined as the Alaska Highway Route in the definition of Mainline. So the contract does not apply to an over-the-top route. Nor does the contract provide any rights for an over-the-top route.

The State is not giving up enumerable rights and huge economic values as Backbone II claims. The State will receive approximately the same revenues on gas as it would have received under the 2005 fiscal terms. Furthermore, the Alaska Gas Pipeline should induce more exploration, and the State would benefit from the resulting oil and gas discoveries. Therefore it is misleading to say that the State receives absolutely nothing in return for this contract.

Also see answer to Item 13.

11. The contract is being falsely portrayed as the only option Alaska has to build a gasline.

The State has always been willing to consider all applications under the SGDA. A review of the record shows that the State engaged in serious dialogue with all applicants and seriously considered all proposals. Based on the State's discussions and negotiations with all SGDA applicants, it became clear that because they [the Producers] had the gas and were ready, willing

and able to negotiate and build a gas pipeline which would allow the State to monetize its gas, pursuing a contract with the Sponsor Group would be the most expeditious way to secure a project under terms favorable to the State.

The State had numerous discussions and negotiations with MidAmerican Energy Holdings Company. The State has always been willing to explore a contract for fiscal terms related to the gas pipeline project. However, in the State's view, without a commitment from the North Slope lease holders to supply gas, MidAmerican's demand for an exclusive right to build, own and operate the gas pipeline would not have resulted in a project. MidAmerican's demand for exclusivity was non-negotiable from its point of view and it therefore withdrew its application when the Governor refused to agree.

Similarly, the State engaged in numerous and serious discussions with TransCanada. While the State and TransCanada achieved consensus on many major issues and began development of a contract, the State determined that it was in Alaska's long term interests to concentrate on the Sponsor Group application because the North Slope Producers have the rights to ANS gas that is necessary to underpin the project. This will lead to more timely development of the gas pipeline. The State has always sought TransCanada's involvement in the project. The State believes that TransCanada's involvement in the Canadian portion could expedite the project.

Enbridge, Inc. also submitted an application and the State held preliminary talks with it. Enbridge was not willing to incur significant expenditures related to its application and did not, therefore, enter into a reimbursable agreement with the State. A reimbursable agreement would have enabled the State to retain independent contractors to review the Enbridge proposal. Thus, negotiations with Enbridge have not advanced beyond the application stage.

12. The contract prohibits the State from enforcing Point Thomson leasehold development and production requirements

The amended DNR decision of October 27, 2005 found the Point Thomson Unit (PTU) Agreement to be in default. Contrary to Backbone II's implied conclusion, that decision did not call for the return of the PTU leases to the state. The decision did call for "a plan to bring the PTU into commercial production within a reasonable time frame", and provided dates for initiation of development operations, commencement of drilling, and commencement of production. Because these dates are inconsistent with the work commitments contained in the contract, that default decision has been stayed, pending conclusion of deliberations on the contract by this legislature.

The state recognizes that:

1) historically, continuance of the PTU unit and leases has, until the latter half of 2005, been with the concurrence of DNR commissioners of several administrations of varied political perspectives;
2) PTU gas is critical to successful conclusion of a gas pipeline contract and to completion of the project;
3) no DNR or State rights have been given away or extinguished by granting the stay; and
4) if the current owners fail to meet PTU commitments specified in the contract (commit PTU gas in the initial open seasons and apply within 6 months to AOGCC for pool rules) or if the contract fails after execution for any reason, the current owners' rights to Pt. Thomson expansion leases terminate unless they initiate development within one year of the contract termination.

The state can also embark on the process of terminating the unit and reclaiming the remaining leases.

13. The only work commitment in the contract is for the participants to "begin project planning".

Producer company work commitments to the Alaska Gas Pipeline project have already begun, and have been actively pursued by the producer companies for several years. They spent 125 million dollars in 2001 and 2002 to develop a preliminary project plan,

including assessment of cost, technology, regulatory and environmental issues associated with the project. In 2004, the producer companies paid the state 1.5 million dollars to reimburse state contract negotiation costs. In addition, each company has incurred its own substantial ongoing costs in support of negotiations, development of the contract and other agreements, and related Alaska Gas Pipeline matters.

The work commitments contained in the contract are simply the next stage in the commitment already shown to-date by the producer group to complete the Alaska Gas Pipeline project. The work commitments contained in the contract are comparable, and actually stronger, than those contained in agreements with other governments for development of large and very large, complex, international projects.

The producer group has committed to start the "Project Planning" of the project within 90 days of execution of the project, and then to advance the project as diligently as is prudent under the circumstances. In fact, the producers must continue to advance the project even in the event of a judicial challenge, until either the project planning phase is completed, $120 million have been spent, or 15 months have passed.

Proper project planning is critical up-front to revalidate the 2001-2002 work and to prepare for the major investments and commitments made during the next stages: front-end engineering, field evaluations, the Open Season, and permitting. As project development proceeds; particularly on a project of this magnitude, scope, and complexity; information must be continually integrated and incorporated into the project scope, design, timing, and cost forecasts. Control of the process will be documented with periodic updates to the project plan.

If, instead of work commitments appropriate for such mega-projects, schedule-driven commitments are imposed, the project development begins to be driven by schedule, rather than sound planning, assessment, engineering, implementation and construction practices. Experience has shown that the result is always cost overruns – usually massive cost overruns on a mega-

project such as the Alaska Gas Pipeline. Because of this experience, the producers cannot prudently commit to build the Alaska Gas Pipeline if they are contractually committed to a strict development schedule. No prudent corporate management could commit to a tight timetable before it knows the terms and conditions of the federal authorization (FERC) or permits it must receive before it can start construction.

Any applicant which claims to be willing to do so should be viewed by the state very critically, because that applicant has demonstrated willingness to violate stern lessons-learned from many mega-projects in the past, and, by doing so, to magnify the likelihood that the state, directly or indirectly, will bear the brunt of major project cost overruns and delays.

The work commitments contained in the contract were crafted to ensure the next stage of the project is started promptly, and that a disciplined, thorough project management process is implemented and maintained to control development and construction of the Alaska Gas pipeline, ensuring the most cost-effective and timely project completion possible, and minimizing risk to both the state and the producers.

Also see answer to Item 10

14. The contract provides for Alaska hire only if Alaskan workers' rates are equal to or less than the costs of non-Alaskans and companies.

This is a misleading statement. Article 6.1 requires, to the extent permitted by law, the employment of Alaska residents and contracts with Alaska businesses provided, among other things, that they are "competitively priced in that they offer goods or services ... at a total cost that is equal to or less than the total cost of equivalent goods or services offered by a non-Alaska resident or a non-Alaska business." Backbone II interprets this to mean that Alaska workers' "rates" must be equal to or less than those of non-Alaskans. Presumably, by using the term "rates", Backbone is suggesting that if an Alaska labor rate is, say," $20 per hour and a Louisiana labor rate is, say, $10 per hour, the Alaskan need not be

hired. This is not correct. The language of Article 6.1 speaks to comparability in terms of "total cost" to the project, not just hourly labor rates. Thus, travel costs to and from Alaska, as well as food and housing costs to the project would all enter into a determination of whether the total costs of hiring a Louisiana worker exceeded those of an Alaskan.

Certainly, Backbone II cannot be taking a position that if an Alaska worker or business costs the project more than a non-Alaska worker or business the project nevertheless must hire the Alaska worker or business, and even be required to do so regardless of how large the disparity. Financing of this project, of which the State is a 20 percent owner, requires that costs be kept to a minimum and if workers or businesses must be hired even if they are not competitively priced, financing may become impossible. No responsible organization should be advocating a provision that could make the project uneconomic. As now written, the Alaska hire provision fully meets the Governor's Principle #6 that Alaskans deserve and will be trained for pipeline jobs.

15. The contracts allows the participants to amend the project plan each year.

All amendments to the Qualified Project Plan are subject to the diligence standard. Producers cannot amend the plan just to delay the project. As anywhere else in the world, a project plan of such a large project is amended whenever to do so is prudent under the circumstances. The companies receive fiscal certainty under the contract and provide an active work commitment and high gas revenues to the State and municipalities as agreed in the contract.

Also see answers to Items 10 and 13.

16. The contract specifically states that the parties are not required to sell natural gas to an Alaskan purchaser.

Again Backbone II misleads by engaging in selective quotation from the contract. What the contract says is that "Any Party may supply

Gas to Alaska purchasers, but no Party is required to sell Gas to an Alaska purchaser."

First, the State will itself have nearly 20 percent of the gas to market. It can elect to sell gas from its share to serve in-state markets as needed and on such commercial terms as the dictates of the Alaska constitution and State law require.

Second, Backbone II ignores the fact that the contract provides for:

(1) a study of in-state needs before the open season,
(2) for four offtake points for in-state delivery at the expense of the project,
(3) mileage sensitive in-state rates in the open season, and
(4) cooperation by the mainline over interconnections with parties who desire to build in-state laterals.

Potential in-state buyers will face the commercial reality that no party will want to sell gas for less than its market value. A contractual requirement otherwise would have required an economic concession, or subsidy, that would have cost the State an equal economic concession elsewhere in the contract.

17. The contract does not require the producers to expand the pipeline to take third party explorer gas, or for incremental expansions for instate use.

Backbone II argues that because the producers will bid for capacity in the State's name, the State's gas will go to Alberta and the State will have to pay the full cost to Alberta if it wants to take its gas off in Alaska. Backbone appears to be arguing about expansion in the above bold face type but the text that follows deals with the entirely different subject of how the capacity management article operates.

Again Backbone II has misread the contract and its point is misleading. First, the pipeline must offer in the open season a tariff for in-state usage computed without regard to costs outside

Alaska as well as a long haul tariff. Under the capacity management article, the State has the right to bid for some short-haul capacity (with a short haul rate) as well as long haul capacity according to the State's desires at the time of the open season. This carve out for in-state capacity means that the State's gas will not automatically go to Alberta if the State wants part of it to travel to in-state markets. Because there will be a short haul rate by order of the FERC, the State can take advantage of that rate for shipments in Alaska and will not pay the full cost of sending the gas to Alberta.

If a third party cannot find capacity on the Alaska portions of the project once it is operational, the contract gives the State the right to initiate the expansion process within the entity owning the pipeline provided certain conditions are met. The expansion process then becomes subject to the FERC process, including its open season requirements. As a general matter, the open season process is available to all so the third party explorer must bid against other potential users of the capacity. To require that the open season for the expansion capacity be limited to independent explorers would raise an issue of potential unlawful discrimination. So the contract goes as far as it reasonably can by giving the State the right to initiate an expansion on behalf of an independent shipper.

The independent explorer also has an alternative remedy. It can invoke the unprecedented mandatory expansion provisions of the Alaska Natural Gas Pipeline Act (ANGPA) enacted by Congress in 2004. If it makes it case at the FERC, then ANGPA provides that the expansion capacity must be contracted for by the shipper that filed the expansion application. In this case, the specific statutory provision appears to override the more general prohibition against unlawful discrimination.

18. The contract requires the State to defend and indemnify the participants against any loss arising out of their failure to perform an obligation under the contract.

This is a vast overstatement at best. Contrary to Backbone's claim, the contract does not allow "an outrageous transfer of potentially

immense risk to the State", nor does it "allow the industry to act recklessly at the expense of the State." Rather, the contract requires the participants to perform many obligations (*e.g.*, build the project with diligence) where indemnification by the State is simply not relevant.

In a few specific instances, there are indemnification provisions added, and for good reason. For example, under Article 10 dealing with capacity, the State has agreed to indemnify each producer and producer capacity holder against losses arising out of the producer capacity holder's action or inaction regarding its capacity obligations, except where fraud is involved. The quid pro quo for this is the unprecedented obligations that the producer capacity holder will assume in order to ensure that the State can acquire and maintain capacity rights on an equal footing with the producers.

Backbone II further claims that the State "alarmingly indemnifies the producers from the costs associated with state regulatory actions and actions by other governments." This presumably is a reference to Article 8.3, which addresses the RCA's authority over the project, and to Article 21.3, which addresses actions that may be taken by political subdivisions.

As already discussed in Item 8, the RCA has no regulatory authority over the pipeline itself, the GTP or interstate gas transmission lines. If nonetheless the RCA asserts jurisdiction and takes actions inconsistent with federal regulatory principles, and a loss to the companies results, then the companies could initiate a dispute to recover from the State losses they incurred. (Those losses would not include any lost profits.) The potential State liability under this provision must be considered in light of the almost non-existent likelihood that this string of events will occur.

With regard to losses incurred on account of actions taken by political subdivisions (*e.g.*, a new tax forbidden under the contract), the State has agreed to indemnify the participants against any losses they may incur insofar as they relate to the participants' fiscal obligations under the contract. In the contract, the State is agreeing to provide fiscal certainty to the participants and it is

reasonable to indemnify them in the event a political subdivision takes an action that attempts to undercut that certainty.

Finally, the contract also provides for State indemnification in situations where the State fails to make full payments of amounts due. Article 22 provides that in those situations a producer may recoup or affect an amount due by either receiving payments due under a State gas sales contract or reducing the volume of gas that the producer would otherwise deliver to the State. The contract further provides that where the producer reduces the volume, the producer shall acquire from the State the capacity related to the reduced volume and may acquire an assignment of State gas sale contracts also related to that reduced volume. For any such capacity or assignment actions, the State has agreed to indemnify the producer from any loss (as limited under Article 37.2). By making full and timely payments, the State is entirely in control of whether it will have to indemnify.

19. The contract forces the state to agree to binding "take or pay" shipping commitments costing billions for a quantity of gas it doesn't control.

In order to further the project, the state has agreed to take gas in-kind for both royalty and tax payments. That decision requires that the state make long-term shipping commitments just the same as would any other major shipper of gas. Those commitments will be paid from the revenues gained by marketing state gas. As a result, the state is accepting risk that gas marketing revenues might be inadequate to meet those shipping commitments. This risk is mitigated, as provided for in the contract and as discussed in the fiscal interest finding, in several ways:

1) because the magnitude of the monthly shipping commitment is directly related to the total construction cost, including all cost overruns, work commitments must provide the flexibility for the state and the other parties to plan and manage this mega-project in the most disciplined and effective manner to ensure construction costs are minimized;

2) the contract ensures that the state does not incur disproportionate shipping commitment ("Capacity") risk – the

contract ensures the state can get our gas to market when produced and that the state does not bear disproportionate risk, with respect to the producers, of holding unused capacity;

3) the PPT legislation and the Uniform Upstream Fiscal Contract provide incentives for investment and a level playing field for new explorers – minimizing the risk that the pipeline might not be kept full for the term of the contract;

4) the state "rides the coattails" of the producers when it comes to managing shipping commitments in the pipeline; and

5) under the terms of the contract the state marketer will receive the same information (production forecasts, field maintenance and pipeline operational bulletins) at the same time as producer marketers.

The state's risks incurred in accepting shipping commitments, and the state's risks with respect to the producers have been evaluated and have been found to be measurable and limited, when compared with the benefits and revenues available to the state as a result of the project.

20. The contract requires the State to invest 20% of the costs in all upstream pipelines between the gas treatment plan[t] and the producing units.

The State participates in the gas transmission pipelines in proportion to its expected share of gas in those pipelines, no more and no less. That varies by field. The State has the right to back out of participation in any individual component of the project after it takes capacity in the Open Season for that component. The particular project entity agreements will define those rights. If the State believes that it is not in its interest to continue to invest in one of the gas transmission pipelines, all it has to do is invoke its withdrawal rights under the entity agreements. Specifically, the State will have the right to withdrawal from participation with full recovery of its prior investment in the event the State decides not to proceed with the investment on the project sanction date. If it continues as an owner in the upstream

pipelines, the state will receive the commensurate reward for its investment based on the tariffs that have been established. Therefore, the State receives the same reward as the other investors with respect to such investments.

Under the current Status Quo, the State already pays for the processing costs of the gas in Prudhoe Bay through a reduction of royalty values, which is 2/3 of the gas in the pipeline during the first 20 years.

The 35% commitment allowance is intended to increase the internal rate of return on the project in the most efficient manner without giving up in total general government revenues. The 35% commitment allowance is designed to reward all shippers who have made a firm transportation commitment to the project.

21. The contract requires the state to take its royalty and taxes as gas-in-kind and directly compete in the market with the producers where they are advantaged by position, special knowledge and mass.

The fiscal interest finding, in sections 6.3.1, 6.3.2, and 8.2.3.4, provides extended discussions of market risks and the options available to the state to market our gas. The state will indeed compete directly with the producers. The producers are not likely to be advantaged upstream due to the unique position of the state marketer, which, alone, will enjoy the perspective from upstream information received from each of the North Slope producers.

Producer marketers are not treated the same. Their interactions in the marketing world are tightly constrained by regulation. They employ very different market strategies all the way from highly proactive marketing operations to simply delivering gas for spot sales at available markets. In addition, many of the largest natural gas marketing entities do not produce their own gas, but seek and enter into contractual commitments to supply their market delivery requirements.

Partnerships, joint ventures or contract marketing arrangements with such entities have the potential of combining the strengths of

the state (large, steady, long-term supply of gas) with the strengths of those entities (highly refined marketing capabilities, presence in multiple markets, forecasting and long-range market development skills, etc.). Some of them have already contacted the State with the idea of entering a marketing agreement. The risks incurred by the state by the decision to market our own gas are manageable and reasonable, and, although of much greater magnitude, are not that dissimilar from past decisions to market some of our own state oil, rather than leaving it in value with the producers. For example, the State currently takes royalty oil in kind and sells it at a premium to Flint Hills and Tesoro.

Moreover, the State has a key competitive advantage relative to the producers – the State pays no federal income tax, giving the State an edge in competing for customers and markets. The State can also preferentially direct its sales to in-state markets.

Finally, the concept of RIK / RIV switching is incompatible with the contract carriage of gas pipelines and the SGDA recognizes this.

22. The contract bases construction impact payment amounts on 2001 prices with no accommodation for inflation.

This is factually inaccurate. Information Insight did a study (that is on the Municipal Advisory Group website, and all the numbers in this paragraph are on page 94) and concluded that impact costs to Municipalities would about 120.6 million dollars in 2004 dollars, offset by about 10.7 million dollars in increased property taxes (though no analysis was done of increases from other tax sources.) Thus the maximum incremental costs to municipalities would be about 109.9 million in 2004, (not 2001) dollars.

Instead under Article 18, owners of the pipeline are making six payments that total 125 million in money of the day (although any payment made more than 9 years after the effective date is also escalated.) Recent historical inflation rates suggest the 125 million dollars as defined in the contract may yield a higher dollar figure than the actual 109.9 million dollars identified in the study.

23. All the risks that the State of Alaska is being asked to take on are designed to protect the oil companies. It puts the Permanent Fund at risk on matters over which the State has no control, as the oil companies will be in control.

Nothing in the proposed contract involves payments or investments by the Permanent Fund. In fact the opposite is true. The royalty contributions to the Permanent Fund are specifically assured in the contract. These contributions will be essentially the same as under the Status Quo since there was no change in the royalty percentages.

The State is not being asked to protect the Producers. The State only assumes risks with respect to its own share of the gas and its own share of the midstream investments. The State has full control over how it wishes to manage its own risk exposure, it is not dictated by anyone. In fact, the State has specifically negotiated provisions under the contract under which the State gets favorable treatment from the companies in capacity management and options in capital contributions during the investment in the gas line.

The State has full ability to reduce much of the risk significantly if it so wishes by selling large volumes of gas at the wellhead under large contracts and thereby avoiding shippers and marketing risks.

24. The contract contains no fiscal certainty for the State.

There is complete certainty that the State will receive all the payments that have been agreed to. There is complete fiscal certainty for the State. In addition, the Political Subdivisions will also have stability in the portion of PILT payments made payable directly to them.

25. The contract locks in oil and gas tax breaks for up to 45 years, with or without a gas line.

There is absolutely no provision in the contract that gives the companies a monopolistic right to market the gas of the State or

the gas in Alaska. The PPT tax regime under very conservative oil price forecasts will increase State revenues by a billion a year. It is therefore not correct to call this a low tax rate scheme. And if future legislatures see fit to adjust PPT downwards to attract additional investment, the producers will continue to pay PPT under the contract rate.

The fiscal stability period for oil is not 45 years but 30 years. If the project sponsors do not diligently advance the project in accordance with Article 5, the fiscal contract will be terminated, including the provisions for fiscal stability.

It is not correct to proclaim that the State has concluded the contract in exchange for absolutely nothing. Under average gas price forecasts the State will receive $ 1.7 billion per year in constant 2006 $.

It is completely normal to dedicate gas reserves to a project of this magnitude. Finally, if the producers do not develop the project with diligence, the State can terminate the contract by the terms of the contract and, once terminated, the companies lose the benefits of fiscal stability. They also lose the benefits of fiscal stability if they withdraw from the contract.

26. The contract allows tax breaks to apply to producers, affiliates and subcontractors.

The harm from this, Backbone II goes on to assert is that "there is a multiplier effect of the credits that works against the revenue interests of the State, the impacts of which can not be forecast."

The contract minimizes taxes on the project while under construction, recapturing that value in Payments in Lieu of Tax (PILTS) once the project is up and running and producing cash flow. To do that effectively, (and not make it less advantageous for the project sponsors to use local contractors and subcontractors) the contract is structured where a tax might increase the cost of the project, whoever is paying it in the first instance gets the "tax break". A contractor will only have the exemptions in this contract if they can demonstrate that the costs were directly passed on to the Project or the properties.

On a general note, while the Alaska portion of the project is estimated to cost 7 (or 9 or some other figure) billion dollars, we do not know how much of that will be spent instate and how much out of state, and thus cannot precisely forecast all the potential tax effects. More specifically, as there are no tax credits created under the contract it is easy to forecast their effect: zero.

27. The contract allows tax breaks to apply to facilities and activities outside the state of Alaska. (Section 9.5)

Section 9.5 of the contract requires the owners of the gas line to conduct a feasibility study for NGL processing opportunities in Alaska. This is intended to create economic opportunity for Alaska. Without the required study, some of the producers' prejudices might only be to examine NGL plants closer to existing NGL infrastructure farther south. If the plant is located outside of Alaska, Alaska can't tax it so there would be no taxes to give inappropriate breaks on. If the NGL plant is located in Alaska, its PILT payment will be negotiated under article 16.6

28. The contract was unfairly negotiated as a sole-source contract.

The State has scrupulously followed the requirements of the SGDA in negotiating the current contract. It is not sole source. As discussed earlier, the State accepted numerous SGDA applications. It engaged in serious and substantial discussions with all applicants. The State then focused its resources on the proposal most likely to result in timely construction of a gas pipeline project without undue litigation delay.

Backbone II seems to represent that all proposals are easily comparable. The fact is, however, that the producers' proposal is the only one that brings the leaseholders to the table and commits their gas to the project. This is a determinative advantage over all other proposals.

The maximum benefit for residents of Alaska occurs as a result of a contract that leads to a gas pipeline project being timely built, not as a result of a contract that may sound attractive but does not commit gas to and advance the project. The contract is not sole source, but recognizes the desirability of negotiating and reaching agreement with parties that actually have gas to commit to the project.

29. The contract prohibits the right to seek court action regarding the legality or constitutionality of the contract.

Any party except the parties to the contract may challenge the legal or constitutionality of the contract. It is nonsensical to allow a party to a contract to execute it and then turn around and challenge it in court. If a party has such grave doubts about a contract, it should not enter into it in the first place.

It should also be noted that the State wanted to make sure that if a judicial challenge is filed, that the project continues to work on project planning and development. For this reason the contract provides that work on the project cannot be suspended until fifteen months has elapsed while the judicial challenge proceeds.

30. The contract trumps the rights of Alaska citizens to impose a tax by the initiative process.

It is the opinion of the Attorney General that it is entirely Constitutional to provide fiscal stability for oil and gas and protect investors from changes in future tax laws either as a result of the initiative process or as a result of legislation by the Legislature. It is not a challenge to the sovereignty of Alaska.

It is an integral sovereign right of the State and countries to conclude long term contracts and provide the related fiscal stability. The railroads would have never been built in the United States without States exercising the sovereign right to enter into such contractual arrangements.

31. The contract requires the State to pay the participants' municipal tax obligations above a certain cap set in the contract (section 11.)

On this moral/ethical issue, Backbone has it exactly backward. Under section 11.3, with certain exceptions, most already existing in law, participants will pay any municipal tax levied on them. The local taxing jurisdictions are kept whole, and can make sure they are kept whole under their own ordinances, boards of equalization and other democratic institutions. Then under the contract, if those payments have exceeded certain amounts or other tests, the state will reimburse the taxpayer. The state is never paying a municipality for "a participants municipal tax obligation." That remains the taxpayers' obligation.

32. The contract prohibit municipalities from seeking court or other administrative action regarding the parties' fulfillment of obligations under the contract. (Section 21.3)

Despite the fact the municipalities are not parties to the contract, "Backbone" goes on to suggest that "this is another taking of our normal and traditional democratic rights of due process, only to benefit the oil industry." Taxpayers – including the oil industry – either pay taxes to local jurisdictions under local ordinances, or make Payments in Lieu of Tax (PILT) under the contract. In the former situation, for sales taxes, gravel severance taxes, excise taxes etc. the local jurisdictions retain all the rights they currently have. In the latter situation a series of tax payments that could have been appealed by either side are replaced by a series of predictable PILTs driven by the variables of inflation and throughput.

33. The contract requires the State to own a percentage of the total project including pipelines and facilities in Canada and the lower 48 states.

This statement ignores the right of the State to withdraw from the project without cost. To begin with, the contract commits the State to taking a share of the various pipelines and facilities equal

to its expected share of gas in each element of the project. This is sound from an economic point of view and is what producers aim for in a project. Even so, the State can withdraw from its participation in each element according to the terms of the LLC agreements for each element of the project. In those agreements, if, at the time of the vote on project sanction, the State does not want to go ahead with the project, it will have the right to withdraw from the project with full recovery of its investment to date.

The State is not required to take an ownership interest in the Alberta to Lower 48 Project if no firm shipping commitments for State Gas are made on that portion of the project. The provisions in Article 7 regarding the Alberta to Lower 48 Project preserve an ownership right in any new infrastructure that might be built if it is needed for adequate takeaway capacity out of Alberta.

34. The contract protects the producers from being liable to the State for any loss arising out of their failure to perform their obligations regarding capacity.

No fair reading of Article 10, which deals with capacity management terms, can lead to the conclusion that only the State has obligations and only the producers have choices, as Backbone charges. Capacity management issues were painstakingly negotiated over many months as the parties sought to create a unique but even-handed way for solving those issues.

The oil companies have assumed obligations to the State that are unprecedented. For example, they have agreed to provisions that, once the pipeline is less than full, ensure to the extent possible that the State and each company will share any excess capacity proportionally. Thus, if the State owns 20% of the capacity and there are 100 units of excess capacity for the entire pipeline, then the State's share of that excess should be no greater than 20 units.

As another example, the producers' capacity holders have agreed to provide the State the same capacity-related information, and to do so promptly, that they become privy to from either an operator or their related producer. In this manner the State and the producers

will be on equal footing in responding to changing production levels that in turn will affect capacity needs.

It was because the Producers were assuming capacity obligations and responsibilities greater than for any other interstate pipeline in this country that they insisted on loss indemnification, except in the case of fraud. In the State's judgment, this is a reasonable tradeoff.

35. The contract was negotiated in secret.

The SGDA sets out specific requirements with respect to applicant confidentiality. When it enacted the SGDA in 1998, the Legislature recognized that for negotiations that involve highly confidential commercial terms to be successful, the State would have to be able to insure confidentiality of proprietary and commercially sensitive information. The State simply could not, in good faith, nor consistent with the terms of the SGDA, negotiate with any SGDA sponsors using confidential information, and then reveal that information.

However, when negotiations were concluded, the State immediately published the contract and a multitude of relevant documents. The State also arranged for extensive public education on the contents of the contract, both on the internet and through numerous public hearings throughout the State.

Thus, the negotiations were conducted in such a way as to protect the legitimate commercial concerns of all applicants. But the contract will not be authorized until it is fully discussed and analyzed by the public and the Alaska Legislature.

36. The contract does not preclude an "over the top pipeline" as preferred by Exxon.

The Alaska Natural Gas Pipeline Act of 2004 prohibits the federal government from permitting an over the top pipeline. This provision was enacted at the behest of the Governor when he was in the Senate. No over the top project is lawful. Further, the

privileges, rights and benefits of the contract extend only to the "project" defined in the contract. The "Mainline" of the "project" is defined as a "large diameter pipeline that is routed generally along the TAPS pipeline and the Alaska Canada Highway." The contract provides benefits only for an Alaska Highway route. That is a complete and total prohibition against an over the top route.

37. The contract subjects construction impact payments to municipalities to appropriation and debate by the legislature. (Section 18.1)

"Backbone" goes on to suggest that "moving the venue of these decisions to the ... Legislature, where the oil industry has great sway" is unfair to individual jurisdictions. Section 18.1 of the contract establishes 125 million dollars in impact payment which will be appropriated by the legislature to those communities being impacted. The contract can hardly direct the payments to the affected municipalities since we do not now know which communities will feel what effects. The legislature can look at and balance relative needs, and coordinate those funds with other programs and spending. The legislature is only going to be directing the use of the funds. It will not - under the sway of the oil industry – be allowed to change the terms of the contract and only ask for impact payments of 110 million, or 100 million. This will most likely be a less chaotic process than having every impact municipality trying to change its fiscal system for just the several years of construction, with all the attendant effects on other taxpayers within the municipality.

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June 2, 2006

The Honorable Jay Ramras
Alaska State Representative
State Capitol, Room 104
Juneau, AK 99801-1182

Dear Representative Ramras:

This letter contains the questions posed during yesterday's House Resources Committee's hearing on the Stranded Gas Development Act Amendments (HB 2004) and the corresponding answers.

1. What are the terms of members of a Municipal Advisory Group (MAG)?

Representatives are appointed to a MAG by the mayor of a municipality. AS 43.82.510(b). State law does not prescribe a term for the representatives. The SGDA does require that a MAG itself is to serve only until final action is taken on the application for which the group was appointed. AS 43.82.510(c).

Section 15 of HB 2004 will amend the law to provide that the MAG serves until the final distribution of impact payment money or until commencement of commercial operations.

2. Whether a tax rate incorporated into a payment in lieu of tax provision of a contract ratified by the legislature can be later modified by mutual agreement of the parties.

This administration does not view the fiscal contract as allowing for any material amendments to the tax related provisions.

However, after careful review of the contract, we believe there is an argument that such an amendment is, at least theoretically, possible. Article 39.1 allows the contract to be amended in writing by mutual agreement of the parties.

To avoid there being such an issue, the legislature could consider amending AS 43.82.435 by adding: "A contract authorized by this section and executed by the Governor may contain provisions that provide for amendment of contract terms without further action by the legislature except that any term relating to taxes described in AS 43.82.210(a), or payments in lieu of such taxes, may not be amended without further legislative authorization under this section."

3. The proposed amendments to AS 43.82.020, in Sec. 2 of HB 2004, authorize the commissioner to negotiate terms for inclusion in a proposed contract for certain adjustments regarding oil and gas lease agreements, unit agreements and other agreements. What are some examples of modification of lease and unit agreements?

The proposed contract provisions (1) redefine upstream royalty responsibilities of the state with respect to payment of gas-related field costs such as cleaning, gathering, treating, and dehydration; (2) assign responsibility to the state for conditioning of royalty gas and disposal of impurities associated with the conditioning of that gas; (3) limit over the term of the contract the state's ability to switch between royalty in kind and royalty in value; (4) define points of delivery for royalty gas; (5) assign responsibility for downstream NGL extraction; and (6) provide an optional alternative royalty rate for certain sliding scale royalty leases.

The contract also contains provisions that amend the requirements for the Point Thomson Unit lessees to submit further plans of development and establishes certain work commitments for the Point Thomson Unit lessees.

4. The issue of Section 6(c) of HB 2004, 43.82.220(1)(c), and ramp up of local gas use–

Many questions were raised concerning the availability of gas for in-state use. The amendments to the Stranded Gas Act are intended to ensure the State has the necessary authority to provide opportunities for in state gas use.

We will have FERC counsel from Morrison Foerster available telephonically to respond to these questions and discuss opportunities for in state gas use under the contract.

5. Compare the case law relating to *"in best interests of the state"* to *"in the long-term fiscal interests of the state"*?

AS 43.82.200 sets standards under which the commissioner of Revenue may develop a contract under the Alaska Stranded Gas Development Act. Under current law, the commissioner may include terms or conditions "necessary to further the purposes of [AS 43.82]; or in the best interests of the state."

Once a contract is developed, before the commissioner presents his preliminary and final findings and determinations to the legislature, he must determine that the contract terms are "in the long-term fiscal interests of the state." AS 43.82.400(a); AS 43.82.430(b).

In our view, having a standard to be met for developing contract terms that is potentially different that the standard necessary to be met for forwarding contract terms is ambiguous and confusing. To date, we have not been able to find any legislative history on the SGDA that discusses why there are different standards for contract terms contained in the act.

It is difficult to describe precisely the practical difference between the standards because the standard "long-term fiscal interests of the state" neither appears elsewhere in Alaska statutes nor has it been interpreted by the Alaska Supreme Court.

The standard "in the best interests of the state," however, does appear in statute and has been interpreted numerous times by the Alaska Supreme Court. The statute most analogous to the SGDA is probably AS 38.05.035(e). Under that statute, the commissioner of Natural Resources may approve contracts for sale, leases or disposals of state land "upon written findings that the interests of the state will be best served."

The Alaska Supreme Court has found that this standard can be traced to Art. VIII, of the Alaska Constitution. Art. VIII, sec. 1 says that "[i]t is policy of the State to encourage . . . the development of its resources by making them available for maximum use consistent with the public interest." In turn, sec. 2 of Art. VIII authorizes the legislature to provide for the utilization, development, and conservation of all natural resources belonging to the state . . . for the

maximum benefit of its people." *Kachemak Bay Conservation Society v. State, Department of Natural Resources*, 6 P.3d 270, 276 (Alaska 2000).

In our view, the standard "long-term fiscal interests of the state" would probably be traced to the same constitutional provisions as the "best interest standard" described above, although it may be a somewhat narrower test than "best interests of the state."

This is because a "long-term fiscal interests of the state" standard focuses on fiscal interests (although it should be noted that the Stranded Gas Development Act requires the commissioner to consider factors such as safe management and operation of the project, mitigation of increased demand for public services. AS 43.82.120(b)), while a "best interests of the state" standard is, arguably, broader.

Because the Stranded Gas Development Act deals primarily with fiscal issues, the "long-term fiscal interest of the state" standard is arguably more relevant and in keeping with the purposes of the Act.

Again, including two distinct standards in the Stranded Gas Development Act raises the issue of why the legislature chose to include a "in the best interest of the state" standard for terms and conditions in AS 43.82.200 and a "long-term fiscal interests of the state in AS 43.82.400 and AS 43.82.430 since all three sections deal with the development of the same contract. There appears to be no particular reason in either the legislative history or from a reading of the rest of the Stranded Gas Development Act. The language change proposed in section 3 of SB 2004 will merely insure that a court considers the commissioners' proposed contract terms and preliminary and final findings under the same standards.

6. Could state law be amended to impose a tax on limited liability companies (LLC) owning a portion of the project?

Under Article 11.1 of the fiscal contract, participant's interests are exempt from taxation except for income tax PILT (SCIT) set forth in Article 19 of the fiscal contract, which is limited to the law in effect as of October 1,2005. If the state were to impose a general income tax on LLCs it is unlikely under the terms of the contract that it could be made to apply to the LLCs that are midstream entities under the terms of the contract.

The members of the LLCs which would be affiliates of the producers would pay corporate income tax under the terms of Article 19 as part of the unitary business of the producer.

In accordance with Article 31.1(b) an assignee of a membership interest in an LLC, that is not an affiliate of a producer, would not receive fiscal certainty with regard to corporate income tax.

We hope this answers the committee's questions.

Sincerely,

Kevin Jardell
Legislative Director

Cc: Representative James Elkins
Representative Carl Gatto
Representative Gabrielle LeDoux
Representative Kurt Olson
Representative Paul Seaton
Representative Harry Crawford
Representative Mary Kapsner

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DEPARTMENT OF REVENUE

OFFICE of the COMMISSIONER

June 21, 2006

The Honorable Bert Cottle
Mayor of the City of Valdez
P.O. Box 307
Valdez, AK 99686

Dear Mayor Cottle:

Enclosed is the state's reply to the points raised in your June 7, 2006, letter regarding the gas pipeline contract. We would welcome any additional thoughts on these issues you may have.

We know Valdez wants the "all-Alaska" Alaska Gasline Port Authority (AGPA) line. But please consider: to provide the state's gas to AGPA, it would take years of litigation by the state, followed by a successful AGPA bid for the oil and gas leases made available by such successful state litigation. The likelihood of both of these events occurring is low.

Instead, why not have AGPA work with this ongoing process, reserve capacity during the FERC open season, and build a spur line from Glennallen to Valdez? We would like to discuss this with you at your convenience.

Sincerely yours,

s/s William A. Corbus

William A. Corbus
Commissioner of Revenue

cc: The Valdez Alaska Gas Pipeline Public Hearing Attendees

Response to Mayor Bert Cottle's June 7, 2006 Letter

1. No Commitment to Build a Gasline

This assertion reflects an inadequate understanding of the contract terms and sound management of megaprojects. The work commitments contained in the contract are the next stage in commitment already being exhibited by the producers to complete the project. The producer companies have been actively pursuing the Alaska gas pipeline project for several years. They spent $125 million in 2001 and 2002 to develop a preliminary project plan, including assessment of project cost, technology, regulatory and environmental issues. In 2004 the producer companies paid the State $1.5 million to reimburse State contract negotiation costs. In addition, each company has incurred its own substantial ongoing costs in support of negotiations, development of the contract and other agreements, and related pipeline matters.

The work commitments contained in the contract are but the next stage in the commitment already shown to-date by the producers to complete the project. Those commitments are comparable, and actually stronger, than those contained in agreements with other governments for development of large and very large, complex, international project. For example, the producer group has committed to start the "project planning" of the project within 90 days of execution of the contract, and then to advance the project as diligently as is prudent under the circumstances. In fact, the producers must continue to advance the project even in the event of a judicial challenge, until either the project planning phase is completed, $120 million have been spent, or 15 months have passed.

Proper up-front project planning is critical to revalidate the 2001-2002 work and to prepare for the major investments and commitments made during the next stages: front-end engineering, field evaluations, the open season, and permitting. As project development proceeds - particularly on a project of this magnitude, scope, and complexity - information must be continually integrated and incorporated into the project scope, design, timing, and cost forecasts. Control of the process will be documented with periodic updates to the project plan.

The project timeline is included in the Project Summary (Article 5.4) and must be updated annually and shared with the Alaska public. The most recent timeline was provided just last month. This document is the mechanism by which the project entities will communicate to all Alaskans how they have been diligently advancing the project. They will provide in this plan a project overview, a description of the work that has been accomplished in the last year, the estimated project schedule with proposed development activities, and a description of expenditures and programs implemented under the Alaska hire provisions of the contract.

It is important to remember that as a 20% owner of the LLC and a member of the LLC's management committee, the State through Alaska PipeCo. will participate in the project planning and oversight of the operator that builds the pipeline. State ownership will provide Alaska PipeCo. a continuing opportunity to know what is going on inside the project company, be heard on key issues and influence the course of the project development.

Providing hard dates in the contract to begin construction would be contrary to all industry best practices for project management. A schedule driven construction project will not deliver the highest value project to the companies or the State. If, instead of work commitments appropriate for such mega-projects, schedule-driven construction commitments are imposed, the project development will be driven by fixed dates rather than sound planning, engineering, and construction practices. Experience has shown that the inevitable result will be cost overruns – usually massive cost overruns on a mega-project such as this one. Because of this experience, the producers cannot prudently commit to build the pipeline if they are contractually committed to a strict construction schedule. Indeed, no prudent corporate management would commit to a tight timetable before it knows the terms and conditions of the federal authorization (FERC) or other federal and state and Canadian permits it must receive before it can start construction.

The fact is that no one can guarantee a date for delivery of gas from this project. Nor can anyone be assured on when they will receive the necessary permits from the U.S. federal government, the Canadian government, and from provincial and state governments for the project, or know what the terms of those permits will be. Given

the uncertainties on permitting, no one today can know the desired delivery date of the 5 to 6 million tons of steel that will be needed for this project. Finally, no one today can hire the thousands of skilled workers to construct the project in the anticipated time frame.

Any applicant who claims to be willing to provide hard dates should be viewed by all very critically, because such an applicant will have demonstrated a willingness to violate stern lessons-learned from many mega-projects in the past, including the early attempts to build the ANGTS, and, by doing so, will magnify the likelihood that the State, directly or indirectly, will bear much of the major project cost overruns and delays.

The work commitments contained in the contract were crafted to ensure the next stage of the project is started promptly, and that a disciplined, thorough project management process is implemented and maintained to control development and construction of the pipeline, ensuring the most cost-effective and timely project completion possible, and minimizing the risk to both the State and the producers.

If, at any time, the State doesn't believe that the project is being advanced diligently, it can terminate the fiscal contract. The potential for terminating the very deal that the parties have spent 3-years negotiating is significant leverage over the producers, as the producers will lose all of the benefits of fiscal certainty if this contract is terminated by the State.

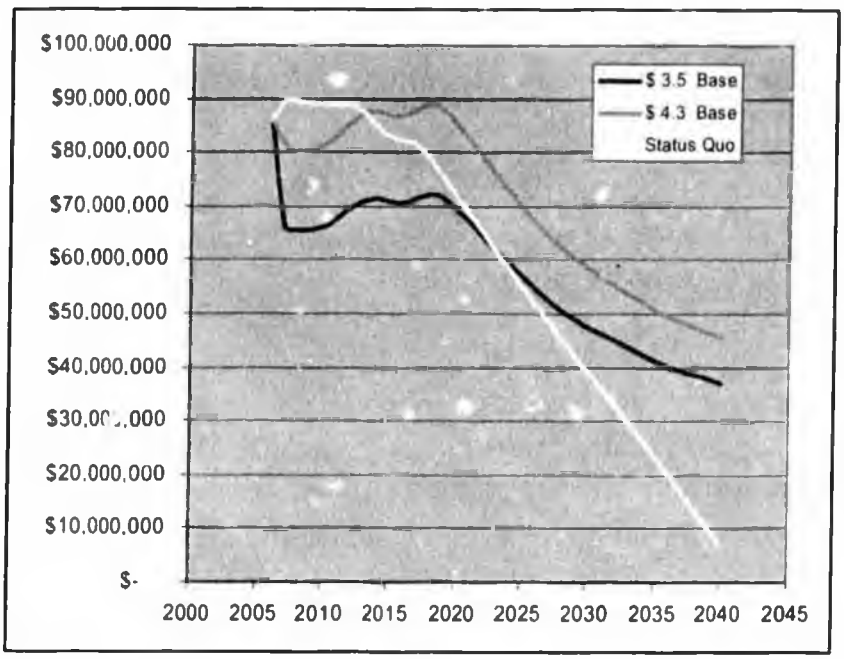
2. Interference with Taxation of Oil Property in Violation of AS §43.82

a. It establishes a new valuation methodology for TAPS.

The cash flow from the PILT on TAPS in the contract translates into a value for TAPS higher than any value seen since 1995 – 3.5 billion dollars. None-the-less, it does not represent the 2006 value of $4.3 billion which is found in the decision – now under appeal by the owners in Superior Court - from the State Assessment Review Board. Our modeling, which State Petroleum Property Assessor, Randy Hoffbeck, has shared with you, shows that some years out, the inflation and throughput driven calculation based on a 2006 value of $3.5 billion results in higher cash flows to the taxing jurisdictions

then the traditional inflation and depreciation driven calculation based on $4.3 billion in 2006.

Although everyone can fully agree that the contract would present a change in this arena, given that we don't know the outcome of the current court appeals and other difficult to forecast events such as post TSM valuation, I urge you to work with us on this problem before rejecting the contract's solution. The following chart shows the cash flows from the status quo and the PILT structure using a $3.5 billion dollar base and a $4.3 billion base.



b. Contract targets the Valdez vessel tax.

We do not agree that the outcome you describe is possible under the words we have drafted. And since that outcome was not our intent we can certainly restate the contract sections so there is no chance for the scenario you have laid out. As we explained to Valdez' attorney, Bill Walker, last month, our intention was to treat this tax like any other tax under AS 29.45 with two exceptions: The first is that unlike any other existing tax, the fundamental question of whether the tax itself is constitutional may still be open. If the tax is declared unconstitutional the contract would not require the producers to keep paying those amounts to the state for the remainder of the fiscal stability period.

The second difference is that because certain taxpayers have signed settlement agreements, it is our intent to treat those, and not the tax as enacted by the Valdez assembly, as the baseline. The contract demonstrates the State's determination not to reimburse a producer a pro forma premium that it had avoided by signing a settlement agreement with the City. Since you have read a different interpretation into the contract, we would like to work with you to make these outcomes crystal clear in the contract.

c. Current cap on oil and gas property is 30 mills.

While you are correct that under law there is 30 mill cap for operating funds in law and no limit on taxes to repay debt, for all practical purposes there appears to be an effective informal 20 mill cap. A history of the City of Valdez' mill rates which rose steadily until bumping into the informal cap may be as persuasive a piece of evidence as any. Thus we believed that fixing the valuation by removing depreciation from the TAPS calculation is a worth while trade for the cap. Depreciation has in fact been eating up the value of TAPS over the prior decades while over that same time period a mill rate above 20 has never been more than a hypothetical possibility.

3. <u>Significantly Weakens the Producers Obligation to Develop Point Thomson</u>

Point Thomson will be developed most efficiently with a gasline. In the absence of a gasline, the gas would have to be re-injected, which due to the very high pressure required would be very costly. With a gasline, much of the gas would come from Point Thomson, and high pressure re-injection would be unnecessary. Accordingly, the greatest incentive to develop Pt. Thomson is a gasline.

Point Thomson development commitments have been subsumed to the terms of contract – but only as long as the contract is in force, and only until after commencement of commercial operations of the pipeline. If the contract fails for any reason, specific Point Thomson development commitments fall back upon the producers and the State retains its full unit management authority. Within the terms of the contract, the producers have recognized their duty to develop Point Thomson as part of their overall work commitments.

Attempts to independently enforce a "duty to develop" will result in protracted legal action, as the producers point out the substantial technical hurdles facing Point Thomson development, as they assert the State's ongoing acceptance through 2004 of their Point Thomson development efforts, and as they provide substantial evidence that since 2004 they have exerted good faith attempts to develop Point Thomson as an integral part of major gas sales. Also, it has yet to be determined whether a Point Thomson development absent major gas sales is consistent with State conservation regulations – because of this, it is not clear that the producers can even obtain State approval of a Point Thomson development scenario in which produced gas cannot be sold.

The amended DNR decision of October 27, 2005 found the Point Thomson Unit (PTU) Agreement to be in default. That decision called for "a plan to bring the PTU into commercial production within a reasonable time frame", and provided dates for initiation of development operations, commencement of drilling, and commencement of production. Because these dates are inconsistent with the work commitments contained in the contract, that default decision has been stayed, pending conclusion of deliberations on the contract by this legislature.

The State recognizes that:

a) historically, continuance of the PTU unit and leases has, until the latter half of 2005, been with the concurrence of DNR commissioners of several administrations of varied political perspectives;

b) PTU gas is critical to successful conclusion of a gas pipeline contract and to completion of the project;

c) no DNR or State rights have been given away or extinguished by granting the stay; and

d) if the current owners fails to meet PTU commitments specified in the contract (commit PTU gas in the initial open seasons and apply within 6 months to AOGCC for pool rules) or if the contract fails after execution for any reason, the current owners' rights to Pt. Thomson expansion leases terminate

unless they initiate development within one year of the contract termination.

The State can also embark on the process of terminating the unit and reclaiming the remaining leases.

4. **Elimination of Judicial Branch**

All disputes under the contract are subject to arbitration according to a carefully balanced set of rules modeled on the rules of the International Center for Dispute Resolution ("CPR"). Arbitration is widely utilized in US and international commercial contracts to resolve disputes. In a number of existing contracts the State has agreed to an arbitration clause and has successfully invoked it. While some may argue that the State is giving up "home court advantage" by agreeing to arbitration, it must be kept in mind that the arbitrators will be applying the substantive law of Alaska. In any event, the relevant question critics should ask is whether the State will be disadvantaged under these arbitration rules. We submit that the answer is clearly no as the rules were specifically designed to treat all parties in an even-handed manner.

For one, the very selection of arbitrators will contribute to a fair, non-partial process. Disputes may take the form of a dispute between the State and one company or between the State and more than one company. In each case, the parties to the dispute jointly try first to agree on the arbitrators. At this stage, there is no voting process; the parties discuss who is qualified and seek to agree on the panel. If agreement is not reached within 75 days, then a neutral body, not the parties, provides a list of qualified arbitrators from their standing lists of experienced arbitrators. After that, each party may strike one candidate. In a single participant dispute, each side gets a single strike from the list. In a multi-participant dispute, each party, whether there are three or four parties, gets a strike but there is no reason to assume that in all cases the producers will take a unified position. Indeed, in a dispute over the expansion provisions, for example, the State and one producer or even two producers could line up in exercising the right to strike against a third company. Even so, the value of striking a potential arbitrator from the list is quite limited because neither the State nor the companies will have the right to nominate preferred candidates to the neutral list proposed by CPR in the first instance.

Likewise, discovery is even handed although you apparently misunderstand the discovery provisions. Discovery is scaled according to the size of the dispute. The largest disputes that could arise under the contract would be disputes concerning the payment in lieu of the new PPT. Those disputes are not subject to any pre-set limit on discovery. The Tribunal decides what discovery is appropriate to the circumstances. That is virtually the same standard as courts apply. The other large disputes that the State has faced in the past such as the disputes about the value of oil or gas for tax or royalty purposes should not arise because the State is taking its royalty in kind and receiving tax payments as gas, not cash, accordingly to a pre-arranged formula.

For small disputes -- generally under one half or one million dollars -- there are limits on depositions. This is sensible unless one believes in enfranchising lawyers to litigate disputes at any cost regardless of the size of the dispute. For disputes over one million dollars, depositions are generally limited to five per party, but the Tribunal may enlarge that. And, "in a Multi-Participant Dispute, each side to a Dispute is entitled to no less than two (2) oral depositions." In other words, there is no maximum limit in these disputes for any party. It should be noted that the Alaska Civil rules also contain limitations on depositions. Hence there is no "absolutely astounding giveaway" as you charge.

With regard to most taxes, municipalities will still have their full rights under their own ordinances and procedures, and appeals may proceed through the normal court processes. For those taxes such as the 43.56 property tax you are correct that, as explained above, we have opted for a value tied to inflation and throughput rather than an uncertain value. But for sales taxes, excise taxes and most property taxes under 29.45, the municipality should notice no difference.

5. Elimination of the Legislative Process

The economics of this project are very fragile. With high prices and no cost overruns it would be a very good project. With low prices and a sizeable overrun it would be a very bad project. The producers are willing to take the downside risk, but it must be offset with upside potential. If the upside, should it materialize, will

be taken away with high taxes, the r k symmetry will be destroyed. That is why the contract contains the fiscal stability period.

6. **Citizen Legislative Initiative Process**

The Stranded Gas Act was structured to replace the statutory basis of administering taxes with a contractual basis. That is the mechanism by which fiscal stability is created. If the ballot initiative process can override the contractual terms, then there would be no fiscal stability.

Moreover, we believe the reserves tax would be very harmful to the State. Even though there is ample evidence the producers are serious about the project, the tax appears as a punitive measure for not having built it previously, even though it did not make sense to seriously consider building the project until recently. Moreover, the producers would have to pay the tax even while building the project. This would create a morbid investment climate in Alaska, and depress the project economics. In addition, lawsuits by the producer companies to overturn the reserve tax could delay the project as well.

7. **Elimination of the State Assessment Review Board Process in the Valuation of the Trans-Alaska Oil Pipeline**

You have correctly characterized this for the signatories to the contract, though not to the other owners of TAPS. Interestingly, while some owners of TAPS may qualify under the model upstream contract, others, which are not producers, may not qualify and may continue to have their portion of the pipeline valued under the general law. You also expressed concern that the contract would not account for reserve additions, presumably by not reflecting the longer pipeline life. The result of basing the PILT on throughput actually creates a more robust and responsive cash flow as new discoveries are brought on line, with the result being additional revenue that will far exceed what would be generated by merely extending field lives. Again, we urge you to closely examine the possible outcomes without a contract with the outcomes under the contract.

8. **Elimination of the Regulatory Commission of Alaska's Jurisdiction Over In-State Use**

This charge reflects a misunderstanding of federal and state jurisdiction over gas pipelines. Legally, the FERC has the exclusive right to authorize the construction and operation of an interstate natural gas pipeline, specifically the Alaska natural gas pipeline in the United States. In this case, that authority extends to the gas treatment plant ("GTP") and the FERC has already demonstrated its jurisdiction by extending the open season regulations to the GTP. Feeder pipelines that supply an interstate gas pipeline also will be regulated by the FERC so long as they are not gathering lines. This is unlike TAPS where federal regulation is far less pervasive and there is dual regulation of rates by the FERC and the RCA.

Thus, the RCA is powerless under federal law, not because of the contract, to regulate the gas mainline, the GTP or the feeders, even if some of the gas in those facilities will be "gas distributed in Alaska." If the RCA should attempt to assert jurisdiction where it has none, its actions would interfere with the scheme of federal regulation and would precipitate unnecessary delay and litigation. Article 8.3 of the contract confirms existing law and is designed to avoid regulatory misadventures. In the totally remote hypothetical case in which the RCA tried to extend its regulation to the project in a way that conflicted with federal principles, the State would seek to cure the conflict. If it failed, the companies could initiate a dispute but recovery in such a dispute would be limited by Article 37.2 (Limitation on Remedies and Damages). Article 37.2 precludes an award of lost profits. So even if the RCA had jurisdiction to find the gas pipeline rates too high, which it does not, the State would not have had to "eat the difference" of lost profits.

Finally, the contract does not prohibit RCA "jurisdiction over gas pipelines for gas distributed in Alaska, as you claim." Section 108 of ANGTA reserves exclusive jurisdiction to the RCA of any local distribution facilities, for example, a spur line from the gas mainline to the Anchorage area. Hence, while those facilities upstream of the spur line would be regulated by FERC to the extent they are not gathering lines, the RCA will have jurisdiction of all local distribution facilities which, by definition, will transport "gas distributed in Alaska." Similarly, if there are local distribution facilities built in Valdez, they would be RCA jurisdictional.

9. <u>Auditing</u>

It is true that the producers can require the State to audit for targeted taxes. However this will seldom occur because (i) existing taxes (such as the tanker tax) can, by definition, never become targeted taxes, and (ii) if it turns out that the tax in question was not a targeted tax, the producers must pay for the cost of the audit. Although we believe the concept of a targeted tax is a worthwhile idea to keep in the contract, we invite your thoughts as to better ways of enforcing it.

10. Royalty In-Kind vs. Royalty in Value

The decision to take royalty in-kind is related to the decision to accept transportation shipping commitments, thereby relieving the producer companies of those commitments and providing improvement to the project economics without giving up the State's share of the resource. Federal regulations governing the shipping of oil and those governing the shipping of gas are very different. The benefits of switching the taking of royalty gas and the taking of royalty oil between in-value and in-kind are very different because of the separate and very different regulatory regimes. Because, according to federal regulations natural gas is shipped under fixed contract arrangements, existing lease rights to switch the taking of royalty gas between in-value and in-kind are of little or no practical value to the State. Acceptance of royalty in-kind requires that the State establish a gas marketing function, but it also frees the State to obtain value for our gas according to our own priorities and strategies.

Taking State gas in-kind provides the state the best opportunity to ensure the most benefit out of our royalty gas. For instance, a producer may be willing to accept higher risks while seeking higher value for Alaska gas, whereas the State might find those incremental risks unacceptable. Conversely, a producer may be willing to accept lower gas prices, whereas the State would prefer to market more aggressively. Rather than attempting to enforce "higher-of" lease provisions in a 'royalty in-value' world, and incurring the legal costs and continuing contentious relationships with the very producers we are expecting to become our partners, the State has the opportunity to help ensure the pipeline is built and to market our gas to best meet the strategies and policies of the State.

The State has a successful record taking some of our royalty oil in-kind and marketing it ourselves. A wide variety of alternatives exist for developing a State gas marketing authority. Major third-party gas marketers exist willing to partner with the State, who are not producers of their own gas and by the very nature of their companies would be natural partners with priorities which would be consistent with those of the State. Gas marketing experts, both within the State and outside, have consistently confirmed the opportunity and potential value available to the State by taking our gas in-kind.

Taking State gas in-kind also enhances the State's ability to meet the critical needs of Alaskans. The State can ascertain the needs of in-state use, determine the policies to be met to meet those needs, and determine the share of State gas to be committed to in-state use.

11. No Penalty for Non-Performance

If the contract is terminated, the producers lose fiscal certainty on all their oil and gas operations in Alaska. That is a substantial "penalty" because obtaining fiscal certainty was one of the primary, if not the primary, objective of their negotiations. Termination would leave the Legislature free to enact changes in the State's tax laws that would be in the best interest of the State in light of changed circumstances. Similarly, if one or more of the producers withdraws from the contract after the open season, there is a different penalty – they must relinquish their holdings in Alaska either by sale to a third party or by forfeiture. The exclusion from the penalty clause of consequential or punitive damages works both ways – it is protective of the State because consequential or punitive damages cannot be recovered against the State if it fails to perform one of its obligations under the contract. Suffice it to say, the State always has available the remedies of the antitrust laws if the producers collectively engage in anti-competitive behavior.

12. Local Hire

Article 6 requires, to the extent permitted by law, the employment of Alaska residents and contracts with Alaska businesses. The SGDA, in turn, requires the hiring of Alaska workers and the contracting with Alaska businesses "to the extent the residents and businesses are available, competitively priced, and qualified." This does not mean, as some have claimed, that Alaska workers' labor rates must

be at the same price or cheaper than labor rates from outside Alaska. Travel costs to and from Alaska, as well as food and housing costs to the project would all enter into a determination of whether the Alaska worker or business was competitively priced. The present wording of 6.2(b) will be changed to assure Alaskans of your intent that Alaskans are hired for these jobs. There will be no repeat of what happened on TAPS. We will have Alaskans now in middle school trained and ready to work on this project.

In addition, we propose, once the contract becomes effective, to begin negotiations with the producer companies regarding a project labor agreement that would expedite the construction of the project. Finally, we also intend to propose initiating discussions and negotiations with the government of Canada concerning a cross-border labor agreement.

13. Gas is not "Stranded"

"Stranded" is defined in the Stranded Gas Act as not being marketed due to prevailing cost and market conditions. We interpret "prevailing" to mean during the construction and operation of the project.

No one can predict with any assurance the level of gas prices over the next 45 years. It is possible to present rationale for prices being anywhere from $1 to $20 or more. What are now considered low probability events will no doubt unfold as history proceeds over this time period. Accordingly, prices could be very high or very low. And coupled with whether costs come in on budget, or whether there are overruns, this could turn out to be either a very good or very bad project.

The prospect of a very bad outcome, in recognition of the great size of this project, raises particular concern. A bad outcome coupled with the size of the project could be a financial catastrophe. Investors look at risk asymmetrically, as well. Downside risk, if it cannot be tolerated by the company, is worse than upside potential is good. It is for these reasons that the gas is considered stranded from an economic perspective. This is described in more detail in the Fiscal Interest Finding.

But there is an additional dimension, as well. Given the factors above, producers are willing to take the downside risk, but they must have upside potential to balance it. If the upside, should it materialize, can be taken away by higher taxes, the risk symmetry of the upside potential and downside risk is distorted. It is for this reason that the lack of fiscal stability itself also contributes to the gas being stranded.

14. State Ownership

The conflict of interest allegation is not correct. The LLC will be established in Delaware. In the draft LLC Agreement under negotiation, the State can exercise its voting rights in the LLC specifically in the best interests of the State without any fiduciary obligations to the other parties, because Delaware corporate law permits the parties to waive fiduciary duties in an LLC; Alaska law does not. This is an important benefit to the State of having a Delaware LLC. Nothing in the fiscal contract restricts the State's rights in this regard and it would be free to terminate the fiscal contract according to its termination provisions. Further, the State intends to have the right under the LLC agreement to withdraw from the project at project sanction and be paid back for its investment to that date.

The question also refers to "other conflicts of interest" in areas of regulatory oversight. As explained previously, by long established federal law the RCA has no lawful regulatory responsibility with respect to an interstate gas pipeline. The State is also completely free under Article 8.4 to challenge or comment upon tariffs or other regulatory matters at the FERC. Again, there is no conflict. The State's authority for other areas of enforcement of its police powers, such as enforcement of its environmental laws, is intact and not modified in any way by the fiscal contract.

15. The Sale of Natural Gas in Alaska

During the contract negotiations Governor Murkowski and his State team insisted on specific, significant terms to provide for in-state needs. A key distinction of each of these producer concessions is that they have been agreed upon, rather than relying upon some form of forced taking of the gas, infringing on the producers' existing lease rights and inviting protracted and expensive litigation which will only further delay an Alaska gas pipeline project.

The contract provides for in-state use in at least 8 separate provisions:

- It reiterates that the pipeline will traverse Alaska thereby providing cost-effective, local access.
- It includes a commitment to support funding of four gas off-take points in Alaska at locations selected after consultation with the State, to be included in the initial construction design.
- It includes commitment to a new study of in-state gas needs, made available before open season plans are filed with the FERC.
- It includes a commitment to conduct a feasibility study for in-state NGL processing opportunities before commencement of the open season.
- It provides for mileage sensitive instate gas transportation rates to be offered at the open season.
- It includes a commitment to cooperate in planning and design with sponsors of facilities downstream of an off-take point.
- It provides for the State to bid at the open season for in-state capacity, separate from export capacity.

It is true that the contract does not force any producer to sell gas to in-state users; however, each producer, and the State itself, has the right to compete for in-state gas sales. Taken together, the above provisions ensure that a healthy in-state market should develop, to the maximum benefit of all Alaskans.

Concerns about the dependability of the State's gas supply have been carefully examined by Governor Murkowski and his team. The gas shipping commitments made by the producers ensure that they will deliver the gas needed to keep the pipeline full during the term of those shipping commitments. Further, the contract specifies that the State's 20% share of the gas must be transported when it is produced to market along with producer gas. With its control of this large volume of gas, the State can ensure that all of the in-state market needs are met.

The contract specifies also that the State gas marketer receives the same information with which to manage State gas marketing activities as producer marketers receive. Finally, if the unforeseen happens, the contract specifies that the State will not bear a disproportionate share of the cost of unfilled shipping commitments.

Finally, it should be kept in mind that ANGDA - a State agency - is currently actively working to ensure delivery of gas for in-state uses. Many of their studies are currently underway and will address in detail in-state use. In addition, ANGDA worked with the Department of Energy on its just-issued (June 2006) study of in-state gas needs.

16. <u>Tariff for In-State Off-take Points</u>

This conclusion that in-State shippers will pay the full fare is incorrect and reflects a misunderstanding of what Mr. Loeffler said. Under its open season regulations for the pipeline, FERC requires the pipeline to offer estimated rates for initial capacity as well as for voluntary expansion capacity. 18 CFR § 157.30. With regard to estimated rates for capacity for in-State delivery points, they "must be based on the costs to make such in-state deliveries and shall not include costs to make deliveries outside the State of Alaska." 18 CFR § 157.34(8). Hence, in the initial open season as well as any subsequent open season in connection with a voluntary expansion, in-State shippers will be offered rates that are considerably less than the full length rate to Alberta or Chicago.

Mandatory expansions, Section 105 of ANGPA speaks directly to that. While the FERC chose not to make the recently enacted open season regulations applicable to such mandatory expansions, it did so with the caveat that these regulations are not applicable only "[a]bsent a Commission order to the contrary." 18 CFR § 157.32. Section 105(e) further provides that the FERC "may issue such regulations as are necessary to carry out their section."

FERC therefore has two avenues to provide for lower in-State rates in connection with any mandatory expansion: 1) it can simply issue an order making 18 CFR § 157.34(8) applicable to any mandatory expansion open season, or 2) it can promulgate new mandatory expansion open season regulations and include the same or similar in-State rate requirements that are in the existing open season regulations.

Given that FERC has now forcefully spoken about the need for lower rates for in-State offtake points in connection with any initial and voluntary expansion open seasons, it is hard to envision any circumstance where a mandatory expansion ordered on account of a shipper request for in-State deliveries would not impose the same in-

State rate methodology. Even in the event that a mandatory expansion proceeding was initiated because of a request by a full length shipper, if there was an in-State need for gas at that time, an in-State shipper could participate in the mandatory expansion proceeding and seek the same lower in-State rates. The State would expect that such a request for a lower in-State rate would be granted by the FERC given its pronouncements to date.

17. **Prohibits its Municipalities from Seeking Court or Administrative Action under the Contract**

This is true – but only for matters under the contract. For remaining local taxes while no course of action is available under the contract, none is needed because the municipality (or the producer as a taxpayer) has all the traditional enforcement and protest pathways still open to it under law.

18. **School Funding**

We agree with your analysis of the school funding issue, and it was never our intent to diminish the school funding mechanisms. Thus as the outlines of the contract became clear, we requested (and both the bodies of the legislature accepted) language to make sure the assets which though tax free had associated PILTs, would remain in the tax base at full and true value. While this bill did not pass out of the legislature in the first special session, we encourage you to support this bill when it comes up in the next special session.

FRANK H. MURKOWSKI
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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

July 12, 2006

Ms. Karen L. Hunt
President, Commonwealth North
810 N Street, Suite 202
Anchorage, AK 99501-3293

Dear Ms. Hunt:

RE: June 9, 2006 Critique of the Stranded Gas Fiscal Contract

Enclosed please find the administration's response t the June 9 critiques of the proposed Stranded Gas Fiscal Contract as reported in the media. I would also like to raise a more fundamental concern that contract critiques have tended to neglect the bottom-line question: What is the overall risk and return to the state—with and without this gas pipeline project?

From the administration's perspective, we are confident that the risks to the state of not approving this contract far outweigh any risks in this contract. We believe that this fiscal contract provides the best chance of getting North Slope gas to market as soon, and as economically, as possible. Our analyses show that the state has retained its fair share of the resource value, while providing the producers the economic incentives and fiscal stability they need to proceed with this enormous undertaking and invest substantially in the North Slope.

For the purpose of public policy debate among your members, I am enclosing other response documents, which the administration's team has prepared. I encourage you to post the administration's white papers on your website and give copies to your membership. We would be happy to provide any other follow-up papers for additional discussion.

We greatly appreciate the opportunity to participate in the educational briefings that your organization has held during this past month, providing a

forum for the administration's gas team to discuss the contract, our reasons for arriving at this agreement, and the implications to the state with and without a contract.

Very truly yours,

James F. Clark
Chief of Staff

Enclosures:
Gas Pipeline Criticisms Response
Backbone II Response
Mayor Bert Cottle Response

cc: Rick Barrier – Executive Director, Commonwealth North
Kay Cashman – Petroleum News
Rose Ragsdale – Alaska Journal of Commerce
Larry Persily – Anchorage Daily News
Rod Boyce – Fairbanks NewsMiner

Responses to Contract Criticisms
Presented on June 9, 2006 to Commonwealth North

The Murkowski administration has presented a proposed Stranded Gas Fiscal Contract between the state and the producers. The case for this contract has been presented in the related fiscal interest finding, in presentations to the legislature, and during eight public hearings and numerous community presentations held around the state. Nevertheless, I feel it necessary to respond specifically to statements attributed to former DNR officials in the June 18, 2006 issue of Petroleum News. In that article, subtitled "Contract a bad deal", I counted well over 20 specific misrepresentations or unsupportable conclusions presented as fact. These can be summarized in five general categories:

- The contract includes unacceptable risks and costs to the State
- The state isn't getting the best deal
- The contract isn't fair
- The state is giving up its sovereign rights
- The state is accepting a disadvantaged position

Each of these categories is discussed below, providing a concise rebuttal to each misconception, and explaining the agreement negotiated with the producer companies.

"The contract includes unacceptable risks and costs to the State"

At a gas price of $3/mmbtu, the state makes 47 billion dollars. At a gas price of $5.50/mmbtu, the state makes 100 billion dollars. Both figures are net of all costs to the State and are far from the negative position portrayed for the state. In fact, the terms of the fiscal contract align costs and risks, allowing the producers to move forward with the costs and risks of pipeline investment and providing the State a major source of new revenues for the future. The terms of the fiscal contract also provide the state with bottom-line economic benefits similar to those benefits which would be available to the state in the illusory 'status-quo' world.

Acceptance of specific costs within the contract, portrayed as a "$13.25 billion dollar cost to the State", has been criticized – in particular the upstream cost allowance (UCA), processing subsidy, marketing costs, loss of the 'higher-of' benefit, and upstream and midstream credits – while the fact that all of these costs are in fact incorporated in the bottom-line benefit to the state, discussed above. The UCA continues an existing upstream payment structure imposed as the result of court settlement. Under the contract, though, the state obtained other contract benefits in exchange for expanding the UCA. The processing subsidy, estimated to be $440 million dollars, is incurred over 35 years at the rate of about 4 cents/MCF shipped and sold. The cost of marketing state gas, reported as $1.4 million, was estimated by DNR analysts to be $310 million in undiscounted dollars. These costs, taken together, are part of the overall contract balance and are incorporated into the overall benefits to the state, as discussed in the fiscal interest finding.

The history of the 'higher-of' benefit is that, for oil, it has been highly contentious. The state and the producers have spent millions of dollars, and many years in multiple court battles arguing over just what this provision means and what that value is. For that reason, the 'higher-of' benefit for oil has largely been contracted away in royalty settlement agreements unrelated to this contract. In each of these agreements, the DNR has determined that it is in the state's best interest to give up the lease "higher-of" provision in exchange for clarity in the determination of oil value.

The Fiscal Contract makes a similar trade for gas – but in this case the "higher-of" provision is of far less value to begin with. The benefits of switching state take of royalty gas and the benefits of switching state take of royalty oil between in-value and in-kind are very different because of the separate and very different transportation regulatory regimes. Because, according to federal regulations, natural gas is shipped under fixed contract arrangements, existing lease rights to switch the taking of royalty gas between in-value and in-kind are of little or no practical value to the State.

The upstream and midstream credits actually are part of the proposed PPT tax structure, and are available only once investments are made. The PPT raises the tax rate. As a result, in addition to the benefits of the fiscal contract, at current prices the State will make, through 2050, over $50 billion more under the governor's 20/20 PPT on oil with a gas pipeline than under the status quo ELF system.

These payments and costs have been mischaracterized as subsidies. They are not. The Contract is a business arrangement between the state and the producers to promote construction of an enormous gas pipeline project where otherwise one may well not be built. Payments from the producers to the state and from the state to the producers occur at multiple points along the construction, production, treatment, and transportation process defined in the Contract, but the economic return to the state is maintained. These payments are also each clearly spelled out. They recognize the varying risks associated with costs at various stages of the project. They also recognize the existence of multiple entities with diverse interests including the state; several separate affected municipalities; and the producers, shippers, and pipeline owners which may be affiliates of each other in the beginning, but need not be affiliated as time goes on. The complexity of these relationships demand that the provisions be extensively described in the Contract, to ensure that they are clear and that nothing is hidden or left to dispute.

The decision to take royalty in-kind is the result of the decision to accept transportation shipping commitments, thereby relieving the producer companies of those commitments and improving project economics without giving up the State's share of the resource. Taking State gas in-kind also enhances the State's ability to meet needs of Alaskans. The State can ascertain the needs of in-state use, determine the policies to be met to meet those needs, and determine the share of State gas to commit to in-state use.

Firm transportation costs are incurred as gas is transported to market. The only significant risk related to those firm transportation commitments which the state would not incur in a 'status-quo' world, is the cost of meeting unused pipeline transportation commitments if inadequate gas reserves exist to keep the pipeline full for the term of commitments. This risk has been evaluated and found to be extremely low. In addition, through state leasing practices, tax rules, and the Uniform Upstream Fiscal Contract, the state can adopt policies which encourage the exploration and development to further marginalize the risk of unused pipeline capacity commitments.

"The state isn't getting the best deal"

It seems to be generally assumed that construction of an Alaska gas pipeline is just another project which should be put out to bid so that the most competitive applicant can be accepted. This assumption ignores basic facts. One basic fact is that the producers hold a contract right to the gas through the leases which they won in competitive bidding. A second basic fact is that the producers have spent billions of dollars developing the oil potential and recycling gas to increase oil production and total oil reserves recovered from these same leases. Rather than seek another entity to ship the gas reserves to which they hold rights, the producers have already spent 125 million dollars in 2001 and 2002 pre-planning this pipeline project, and have continued spending millions of dollars moving this project forward.

Granted, much has changed in just the three years since the SGDA was last amended; however, it is incorrect to assume that the fact those changes have occurred means Alaska North Slope gas is no longer stranded. Gas prices have climbed, but steel prices have also risen, and are forecast to rise significantly again by year-end. Labor costs have climbed, and the very availability of adequate skilled construction labor is in question. The uncertainty of forecasting all of these prices and costs over the next decades is tremendous; and the fact is, the changes over the last three years have led to greater – not less – risk to those constructing the pipeline.

The fact is that, even though numerous economic price forecasts have been developed, natural gas prices ten years from now, and through the remaining 35 years of the contract, are unknowable. The history of price forecasting has proven that the ability to foresee long-term prices is poor, at best. The drivers of high gas prices are well known; limited supply, cost of supply, demand growth, infrastructure constraints, and international tensions. Reasons also exist for why gas prices could be low, including technological shifts, re-emerging acceptance of nuclear energy, global warming concerns which affect hydrocarbon consumption, and other low probability events which have ample opportunity to materialize over the term of this Contract.

In addition, given the high cost and complexity of the pipeline, large cost overruns could occur. Coupling the reasonable ranges of price outcomes and of cost outcomes suggest the economics of this project could turn out very positively or very poorly. This economic uncertainty, coupled with the severity of a negative outcome, is one of the primary reasons Alaska North Slope gas is stranded.

Another primary reason the gas is stranded is fiscal instability. The producers are willing to make huge long-term capital investments, accepting the downside risk associated with the range of economic outcomes discussed above, but they must also have the upside potential from the investment. If the upside, should it materialize, be taken away by higher taxes, the expected risk balance is destroyed. This is the reason fiscal stability was called for in the Stranded Gas Development Act, and this is the reason fiscal stability is in the Fiscal Contract.

"The Contract isn't fair"

As written, the Contract is predicated upon the producer companies moving forward diligently to project sanction. The contract includes a specific start date for the work to begin, which is 90 days after the effective date of the contract. The contract also requires the Sponsors to diligently implement the Qualified Project Plan from then onwards until Project Sanction. The effort required to demonstrate that diligence is

massive. The Alaska gas pipeline project will be one of the largest, most complex projects ever undertaken. Planning alone will require multi-million dollar annual budgets; a large, integrated project organization with clear authorities and accountabilities established; long-term, short-term, and immediate-term planning functions with clearly established deliverables; and constant measurement of project team performance vs. those established deliverables. The State, as part of the pipeline LLC, will be part of all of this. Such a massive effort cannot be disguised – nor can it be 'faked' by window dressing. Lack of diligence, if it occurs, can be clearly established by the absence of key project management components. Once the project is sanctioned, substantial commitments will exist such that the producers and the state are equally motivated to complete the project as quickly and as cost-effectively as possible.

Incentives "tied to completion of the project" – in other words incentives which decline with project delay or with cost overruns add risk to the producer companies, and also add risk to the State. Such incentives ensure the producer companies that if this unprecedented, massive, complex project encounters difficulties, their costs will not only increase in order to respond to the delays or overruns – but, they will be further penalized by the incentive provisions for the difficulties. Such incentives also create a tendency to try to 'force' the project to stay on schedule. History and experience with a myriad of large and smaller projects has taught industry that this tendency is the single direct cause of many projects going terribly awry and destroying massive amounts of value for both industry and government. This sort of incentive is exactly the type of provision which the State does not want in this Contract – and for these reasons intentionally did not include.

If, instead of a diligence standard appropriate for such mega-projects, schedule-driven commitments are imposed, the project development may tend to be driven by that schedule, rather than sound planning, engineering, and construction practices. Experience has shown that the result is always cost overruns – usually massive cost overruns on a mega-project such as the Alaska Gas Pipeline. Because of this experience, the producers cannot prudently commit to build the Alaska Gas Pipeline if they are contractually committed to a strict development schedule. No prudent corporate management could commit to a tight timetable before it knows the terms and conditions of the federal authorization (FERC) or permits it must receive before it can start construction.

Any applicant which claims to be willing to do so should be viewed by the state very critically, because that applicant has demonstrated willingness to violate stern lessons-learned from many mega-projects in the past, and, by doing so, to magnify the likelihood that the state, directly or indirectly, will bear the brunt of major project cost overruns and delays.

The diligence standard and work commitments contained in the contract were crafted to ensure the next stage of the project is started promptly, and that a disciplined, thorough project management process is implemented and maintained to control development and construction of the Alaska Gas pipeline, ensuring the most cost-effective and timely project completion possible, and minimizing risk to both the state and the producers.

The contract does provide for a 60-day termination period (Article 5.5(c)(i)). This applies only to termination initiated by the State and consented to by all of the producer companies – in other words, a mutual decision by all to terminate. This is far from the lopsided provision it is characterized as.

"The State is giving up its sovereign rights"

The Fiscal Contract is an exercise of the State's contracting authority to offer fiscal certainty for a period of time to those companies willing to make the commitments and invest the enormous sums of capital necessary to build the Alaska gas pipeline project.

The Contract does change the relationship of the state – as the royalty owner and taxing authority – with the producers for the term of the Contract. It is, however, not a "total rewrite" of the relationship. Contractual commitments are made by the producers as well as by the state. With the exception of specific provisions supplanted by Contract, DNR authorities remain intact. Other State regulatory authorities, including environmental permitting, remain unchanged. Those DNR provisions which are supplanted are supplanted only for the Contract term or until Contract termination.

The State's leasing programs remain intact. The Fiscal Contract does not constrain the state's leasing authority, nor does it destroy the normal competitive leasing environment. The state's competitive oil and gas lease sales are unaffected by the contract. The state's abilities to set royalty rates, the length of primary lease terms, and conditions for lease-term extension are unaffected by this contract.

The Uniform Upstream Fiscal Contract legislation submitted to the legislature along with this contract ensures a level upstream playing field for all producers and explorers. The contract provides that if gas is committed to the Alaska gas pipeline project from a lease and deliveries start within a specific timeframe, the producer receives fiscal certainty under the contract. This provision does not affect lease primary term provisions.

"The State is accepting a disadvantaged position"

Article 10 of the Contract explicitly recognizes that the State, because it does not directly control production, development or explorations decisions, could be disadvantaged with respect to making and meeting gas transportation commitments on the pipeline. The provisions of Article 10 were demanded by Governor Murkowski's negotiating team, in order to compensate for this situation. Those provisions ensure that, throughout the term of fixed transportation commitments, the state obtains shipping capacity to transport state gas to market when it is produced, and that the state does not hold a share of shipping commitments disproportionate with the state's share of production. Mechanisms are defined within Article 10 by which the State and a producer can adjust shipping commitments to maintain this equity.

Acceptance of royalty in-kind does require that the State establish a gas marketing function, but it also frees the State to obtain value for our gas according to our own priorities and strategies. By taking gas in-kind, the State is better able to meet in-state needs, and to market State gas consistent with State risk vs. return priorities. The State has a successful record taking royalty oil in-kind and marketing it ourselves. A wide variety of alternatives exist for developing a State gas marketing authority. Major third-party gas marketers exist, who are not producers of their own gas and by the very nature of their companies would be natural partners with priorities which would complement, rather than compete with, those of the State. Gas marketing experts, both within the State and outside, have consistently confirmed the opportunity and potential value available to the State by taking our gas in-kind.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

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The Honorable Gretchen Guess
Alaska State Senator
716 West Fourth Avenue, Suite 410
Anchorage, Alaska 99501-2133

July 27, 2006

Dear Senator Guess:

In response to your follow-up question:

> **"Were upstream costs associated with gas development for the proposed pipeline included in your analysis? If so, would you provide me the assumptions behind these costs."**

The answer is **Yes** – upstream costs for gas development were included in the analysis.

The costs that were included in the analysis are the following:

- Point Thomson capital costs = $2.0 billion
- Yet-to-Find oil capital costs = $3.0 billion
- Feeder line capital costs = $600 million
- Upstream gas operating costs = (about) $300 million
- Upstream Payments in Lieu of Tax [PILT] payments per gas contract = (about) $90 million per year

With best regards,

Bill Corbus

Bill Corbus
Commissioner

FRANK H. MURKOWSKI
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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

August 23, 2006

The Honorable Ralph Seekins
119 North Cushman Road Suite 201
Fairbanks, AK 99701

The Honorable Gene Therriault
716 West 4th Avenue, Suite 660
Anchorage, AK 99501-2133

Dear Senators:

Thank you for having Rick Harper and Donald Shepler document their concerns related to "basin control". The Murkowski Administration takes seriously any suggestion that the parties to the proposed Alaska Stranded Gas Fiscal Contract would use ownership of the pipeline for anti-competitive purposes. It is in the best interest of the State of Alaska for there to be fair and reasonable access to the Alaska Gas Pipeline for owners of gas yet to be discovered as well as owners of existing natural gas resources. As a basin-opening infrastructure, we expect the pipeline to spawn a vibrant natural gas industry on the Alaska North Slope and encourage further exploration for new gas resources.

Addressing issues raised by these consultants retained by the Legislative Budget and Audit Committee has been somewhat of a moving target. One reason for this is that "basin control" is not a legally established concept. There are no FERC cases or oil or gas treatises that address that concept. Neither Mr.Shepler nor Mr.Harper made clear whether they thought any of the issues that they raised under the umbrella of basin control were either illegal or legal but otherwise undesirable for various reasons. If they are illegal, there is a wide variety of legal controls and sanctions that apply. If they are not illegal but undesirable in their personal views, then one must examine whether the problems are real or fanciful and whether the remedies are appropriate or do more harm than good.

Initially, Mr. Harper and Mr. Shepler were concerned that BP, ConocoPhillips and ExxonMobil would use their majority interest in the proposed Alaska Gas Pipeline to prevent non-affiliated producers from getting capacity in the initial open season. Following comprehensive testimony by the State's counsel, Bob Loeffler of Morrison Foerster, the concern shifted to the way potential future expansions of the pipeline could be manipulated by these three producers to harm non-affiliated producers. Following testimony by Rob Cupina of the Federal Regulatory Energy Commission (FERC) and based on the

Harper and Shepler memos of July 31, 2006, we have summarized the following concerns related to competition that these gentlemen have identified:

1. The specific design parameters of the initial pipeline should be specified in the Fiscal Contract to ensure expandability.
2. The State may want to prohibit a design pressure that is supercritical (dense phase) because the pipeline may not be as expandable.
3. The take-in-kind point for State gas should be moved to Alberta to dispense with the anti-competitive Capacity Management provisions.
4. The preclusion of RCA regulatory oversight should be removed from the contract.
5. Identical fiscal terms should be offered to all other ANS producers without the requirement for firm transportation commitments.
6. Fiscal Contract provisions should provide for a mandatory "voluntary" pipeline expansion under certain conditions.
7. All expansions must have proposed rates that are on a "rolled-in" basis, no matter the financial impact on existing shippers
8. The State should not rely solely on the FERC to prevent anti-competitive behavior of the producer-owners of a pipeline.
9. An independently-owned pipeline is preferable over a producer-owned pipeline.

Responses to each of these concerns are provided in the attachment. You will see that many of the recommendations from Mr. Harper and Mr. Shepler in their effort to address "basin control" actually run counter to the interests of the State of Alaska as an owner and shipper of natural gas and as an owner in the pipeline.

If you would like the Administration to appear before your committees to discuss this analysis, please let me know.

Sincerely,

James F. Clark
Chief of Staff

Response to Memoranda from Rick Harper and Donald Shepler
Dated July 31, 2006
Issues of Basin Control Arising from the Alaska Stranded Gas Fiscal Contract

1. The specific design parameters of the initial pipeline should be specified in the Fiscal Contract to ensure expandability.

The Alaska Natural Gas Transportation Act (ANGTA) of 1976 specified all the design parameters for that originally proposed gas pipeline. That design is of course now out of date. The Sponsors also considered a certain pipeline configuration during their 2001 study but new engineering studies will be conducted following execution of the Fiscal Contract and commencement of Project Planning. Initial pipeline size will be a direct function of AOGCC approved offtake rates for North Slope fields and results of the binding open season. A pre-determined design could result in a suboptimal design that could jeopardize the project. In any event, the FERC has stated in its open season orders that when it receives the application for the project, it will review the design and size of the pipeline to ensure that the needs of present and future shippers can be accommodated.

As indicated in the Qualified Project Plan and the Project Summary, the Sponsors and the State have stated their intention to design the initial pipeline to be expandable. Even though these three companies have significant discovered natural gas resources, they too will have the incentive to explore for additional natural gas once the pipeline is advanced. Additionally, the Sponsors may consider marketing their interest in the pipeline once it is operational. A pipeline that lacked the ability to be expanded would have a lower market value.

2. The State may want to prohibit a design pressure that is supercritical (dense phase) because the pipeline may not be as expandable.

Gas that is above its critical point (i.e., supercritical) is in a dense phase where all the hydrocarbon components of the gas have the same physical characteristics. That means the liquefiable hydrocarbons (e.g., ethane, propane and butane) would behave like the gaseous methane. This design feature is necessary in order to transport liquefiable hydrocarbons that cannot otherwise be injected into TAPS or can be commercially extracted on the North Slope. Using high strength steel and high-pressure would allow such a design.

Contrary to the suggestion of Mr. Harper, the gas will not be in a "plasma" phase. Rather, the gas will be at high pressure, and will have a high BTU content, containing primarily methane, but also ethane, propane and perhaps a small amount of butane. Special metallurgy or stainless steel pipe will not be required, as suggested by Mr. Harper. Systems for in-state distribution will need to be designed to receive the gas at the operating pressure of the mainline, currently expected to be 2500 psi.

We know of no reason why a dense phase pipeline would be less expandable. As previously stated, the lowest cost expansion would be to install intermediate compressor stations. These intermediate stations would operate under the same conditions as the initial stations – both would be designed to handle natural gas that is above the critical point.

The fact is that substantial North Slope reserves will remain stranded if, as Mr. Harper recommends, a sub-critical pressure gas pipeline is built. TAPS, the only pipeline existing from the North Slope, is currently transporting the maximum amount of high vapor pressure petroleum components it is capable of handling. If the gas pipeline is built without dense phase capability, these components – the heavier components in a gas pipeline – will remain stranded, thereby denying the producers, future explorers, and the State of Alaska revenues from a substantial proportion of North Slope hydrocarbon resources.

3. The take-in-kind point for State gas should be moved to Alberta to dispense with the anti-competitive Capacity Management provisions.

The Capacity Management provisions of the Fiscal Contract are not anti-competitive. The only objections received to this provision were from Anadarko and Shell and these were based on a concern that they could not participate in the capacity transactions between the State and a producer. Article 10 was negotiated and designed to comply with all applicable FERC regulations. As stated in testimony, the Administration views the terms of Article 10 as a "pre-arranged deal" which is provided for under current FERC policy. In addition, the Administration plans to have Article 10 vetted with the FERC.

The Capacity Management provisions of the Fiscal Contract are structured to be as close as reasonably possible to the current "royalty-in-value (RIV)" structure. Article 10.3 in the Fiscal Contract provides that if a producer and the State are not in need of Capacity, the producer and the State can release that capacity through normal posting regulations. This provides the State the ability to follow producer

transactions, comparable to the RIV world, but also allows the market to work if there is unused capacity. Therefore, we don't see how this arrangement could be viewed as anti-competitive.

Further, by virtue of the provisions of Article 10, the State will be a competitor in the gas market, so the Administration believes the provisions of Article 10 are actually pro-competitive, not anti-competitive.

Notwithstanding the Capacity Management provisions, moving the take point for State gas away from the unit boundary to delivery points in Alaska or Alberta would fundamentally alter the commercial arrangements at the heart of the Fiscal Contract. State gas, State transportation commitments and State ownership in the pipeline are inextricably linked. If a producer transported State gas to a delivery point downstream of the Mainline, that producer would have to hold corresponding amounts of firm transportation rights. FERC does not allow shippers to ship third-party gas. Shippers must have title to any gas they ship. If the State takes delivery of State gas at AECO, the producers will hold the shipping commitments for the State's gas. As has been testified to repeatedly, removing that responsibility from the producers is the basis for improving producer economics, and that provided the breakthrough needed to give the State the best opportunity to get a pipeline built through negotiations with the sponsors.

4. The preclusion of RCA regulatory oversight should be removed from the contract.

The Fiscal Contract does not prohibit the regulation of the project by the Regulatory Commission of Alaska. If the FERC does not regulate a portion of the Alaska Gas Pipeline Project, the RCA would not be precluded from asserting jurisdiction. However, it is the Administration's expectation, as stated in Article 8, that the project will be regulated by FERC. In that context, it should be noted that Congress gave the FERC unique powers to order expansion of this pipeline. The RCA does not have corresponding powers.

5. Identical fiscal terms should be offered to all other ANS producers without the requirement for firm transportation commitments.

The Stranded Gas Development Act provides for the development of a fiscal contract with project sponsors. The main purpose of the act is to grant fiscal stability to sponsors as a way to encourage development of an Alaska gas pipeline.

In order to address any inequities associated with giving fiscal stability to the producers who are the Sponsors, the Administration has developed the Uniform Upstream Fiscal Contract (UUFC). We will submit a separate UUFC bill to the Legislature and request enactment concurrent with the approval of the Fiscal Contract. This bill will provide an opportunity for other ANS producers to receive essentially the same fiscal [stability] available to the Sponsors.

As a matter of policy to encourage investment in and development of a gas pipe line, the State did not want simply to grant fiscal stability to all ANS producers without a commitment from them to support the project financially. In order for a producer to qualify for the UUFC, that producer must underpin the Alaska Gas Pipeline with a firm transportation commitment. While many of the UUFC terms will be identical to those in the Fiscal Contract, because the other producers will not actually be participating in the building of the pipeline, some of the provisions, although substantially similar, will be modified, and others will not be applicable.

6. Fiscal Contract provisions should provide for a mandatory "voluntary" pipeline expansion under certain conditions.

The Administration is comfortable with FERC policy and FERC regulation. Mr. Shepler and Mr. Harper, however, appear to lack confidence in FERC's ability to implement appropriate regulation:

> "I recommend not presuming that existing FERC regulations and policies will protect the State's interest and prevent basin control, either overtly or through subtle device." (Mr. Harper, July 31, 2006 to Sen. Therriault)

> "If there is reasonable certainty that: (1) the line will be expanded to meet new demand; and (2) the pricing of expansion capacity will be appropriate, most of the concerns about Basin Control will be resolved." (Mr. Shepler, July 31, 2006 to Sen. Therriault, Sen. Seekins, and Rep. Samuels)

The State and the independent producers were very successful in lobbying the U.S. Congress to add the mandatory expansion provisions to ANGPA of 2004, thereby granting FERC the unprecedented authority to force the expansion of a gas pipeline. The Mainline LLC agreement also includes a voluntary expansion provision. These two added vehicles, and the enforcement provisions available under FERC regulation, will protect the interests of non-affiliated producers.

Mr. Shepler's recommended changes, which are also collateral attacks on ANGPA and FERC Orders 2005 and 2005-A, are not necessary and could work against the interest of the State.

- "Mandatory period open seasons" - Requiring periodic open seasons would be costly and unnecessary in light of FERC's authority and other contract protections.
- "Sole-risk expansion" - Giving a single LLC member, whether the State member or a producer member, the unilateral right to cause the LLC to take action that could foster a bad commercial arrangement. The LLC will be most successful in an environment that fosters consensus building.

7. All expansions must have proposed rates that are on a "rolled-in" basis, no matter the financial impact on existing shippers

The State and the independent producers were successful in including the rebuttable presumption of "rolled-in" rates in the recently released FERC open season rules for the Alaska Gas Pipeline. The LLC must propose rolled-in rates for a pipeline expansion unless it can prove that rolled-in rates would not be appropriate and would qualify as a subsidy.

Obviously expansion shippers would want rolled-in rates when they face the potential for paying higher 'incremental' rates when an expansion is inefficient. For the State, this is not necessarily the case. Based on taking our share of gas in kind, we expect to receive and transport about 20% of ANS gas production. The State has a financial interest is protecting its transportation costs for State gas committed in the initial open season. Mandating rolled-in rates could increase the transportation costs for State gas, lowering net back values and reducing the benefits to the people of Alaska, including reduced Permanent Fund deposits. Because there can be no assurances that the volumes that will be proposed for the expansion will be from State lands or even State waters, there is financial exposure to the State.

Mr. Shepler believes that an independently-owned pipeline would always fight for rolled-in rates for expansions. This is not necessarily true because there is the potential for shippers to enter into negotiated rate agreements with pipeline operators. These negotiated rate agreements can, and often do, provide rate certainty to the shipper. This means the shipper is not exposed to rate increases except as defined in the agreement. If such a provision can be negotiated, this would allow the shipper to be isolated from the effects of rolled-in rates. This would mean the pipeline operator would be the one exposed to absorbing the cost of inefficient expansions if the rate charged to the new shipper can only be on a rolled in basis. Mandating rolled-in rates in all

circumstances would expose all LLC members, including the State, to a loss.

The Administration's objective in developing contract terms is to reduce risk to enable a gas pipeline project to proceed, not to create additional risk. Mandating rolled-in rates creates the risk that terms of a long-term deal (shipping commitments) entered into by the State (and others) at the open season could be changed by the action of a third party. This creates additional commercial risk associated with entering into these essential long-term agreements, and also raises a simple question of fairness. FERC has a policy in place to deal with the issue of rolled-in versus incremental rates that will effectively deal with this concern. Rate issues should be addressed at the appropriate time in the appropriate forum, once all the relevant facts are available.

In ANGPA, Congress struck what it determined was the proper balance between encouraging investment by those willing to commit to pay for capacity to get an Alaska pipeline built and encouraging development of additional gas resources in Alaska by providing an opportunity for future access to the pipeline. Congress addressed the issue of how potential shippers may access initial capacity and, if needed, expansion capacity on the pipeline. Competition for initial capacity and voluntary expansions is to be guided by the open season regulations. In any voluntary expansion, the regulations would "provide the opportunity for the transportation of natural gas other than from the Prudhoe Bay and Point Thomson units." Potential shippers who want more capacity than is available or voluntarily proposed can apply for a mandatory expansion

To ensure that a pipeline is constructed, it must be economically attractive to shippers at the time they make their initial commitments. Shippers, particularly those who must invest so substantially to explore for, develop and produce gas resources, may not be willing to enter into long-term financial commitments for the transportation of gas if they believe there is a substantial likelihood that their rates will be increased in the future in order to accommodate expansions. A component of fiscal certainty for the producer must include rate certainty for the transportation of its gas. Increasing uncertainty for initial shippers regarding future rates is inconsistent with the overriding goal of facilitating the timely permitting and construction of an Alaska pipeline project. Mr. Harper and Mr. Shepler appear to ignore the implications for those shippers who are making the pipeline a reality and "opening the basin" in the first place.

8. The State should not rely solely on the FERC to prevent anti-competitive behavior of the producer-owners of a pipeline.

The Administration fully expects FERC to regulate the Alaska Gas Pipeline and is confident with FERC's ability to adjudicate pipeline-shipper disputes fairly and effectively. There is no plausible reason to disregard or discount the FERC's ability to regulate the gas pipeline industry. It has been doing so since the Federal Power Commission (FERC's predecessor agency) was given authority over natural gas transmission in the Natural Gas Act of 1938.

Following the Western energy problems of 2000-2001, the FERC affiliate rules were made stronger than ever. FERC Order 2004 is extremely powerful and gives FERC significant tools to ensure pipelines operate without discrimination.

Mr. Shepler has suggested that pursuing a complaint with FERC is very costly. The State has had a lot of experience pursuing complaints before FERC and has not been deterred by the cost. It would expect to pursue complaints vigorously against any pipeline where the State's interests are being damaged. Further, it is not the case that formal complaints are the only method by which the State can seek remedies. As discussed by Mr. Loeffler and FERC Staff official, Mr. Cupina, FERC has a 'Hotline' which has a good record of resolving issues without a formal proceeding. FERC's Office of Enforcement will rigorously and promptly act if there are questions of noncompliance.

To reiterate earlier testimony, remedies available to FERC for violations of affiliate rules and other regulations include:

- Civil Penalties of up to $1,000,000 per day per violation
- Divorcement (prohibition against pipeline providing discriminatory services to affiliates)
- Incarceration - criminal penalties for willful and knowing violations (5 years per violation)
- Disgorgement of illegal profits

The severity of these penalties provides a substantial incentive to ensure that the producer-owners of an Alaska gas pipeline do not discriminate against other producers.

One point made by Mr. Shepler is that if the Sponsors agree in advance to a position favorable to a non-affiliated producer, that non-affiliated producer would save the cost of FERC counsel and the risk of an adverse FERC decision. This argument does not hold true as other shippers could protest or the FERC could reject on its own motion.

9. An independently-owned pipeline is preferable over a producer-owned pipeline.

By arguing for an independently-owned pipeline, Mr. Harper and Mr. Shepler seem to ignore the reason the producers and the State want to own the pipeline in the first place. A producer-owned pipeline only recognizes the obvious fact that a pipeline will not be built without the backing of the owners of the gas. The right to produce and develop ANS gas is held by the producer Sponsors with the State having the royalty interest. A producer and State-owned pipeline is the most economically efficient way to develop the State's natural gas resources and manage the risk and minimize the costs of that project. There is no independently-owned pipeline company with a balance sheet strong enough to build this pipeline without firm transportation commitments. The way FERC rates are structured, the costs to the shippers are based primarily on the actual cost of the pipeline. If there are cost overruns, normally the shippers, not the pipeline owner, are required to pay. As a matter of fact, the pipeline company has exactly the opposite commercial incentive to a shipper in that if the pipeline costs do grow, the pipeline can actually make more money with a larger rate base. The cost of a higher rate base would be a direct reduction in the value both the State and the producers receive for their gas.

Given the substantial risk of cost overrun on the Alaska Gas Pipeline, the Sponsors and the State are motivated to own the pipeline so they can control the costs. It makes sense for the one who bears the risk of overrun to manage the risk of overrun. BP, ConocoPhillips and ExxonMobil have worldwide experience managing mega projects.