

ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 RES 12665

It is important to remember that the Alaska gas pipeline project is a basin-opening project that will benefit the State and the oil and gas industry in Alaska. Basin-opening projects throughout the world have progressed and been successful when there is alignment between the host government and the leaseholders. The Producers and the State both want a pipeline project to commercialize the known ANS gas resources and open the basin to gas exploration. So, at a very high level we are aligned.

We believe a Producer gas pipeline project will result in maximum value to the State and the Producers. The reason is the Producers and the State have maximum incentive to control costs. Low capital and operating costs, which result in lower treating and transportation costs, and access to premium market price, results in higher netback value on gas. It should be noted that the State will receive the majority of its revenue from the value of gas sales via revenue received under its lease royalty agreements and from production taxes, which are valued based on the netback received from the gas.

Third-party owners do not share the same incentives in that they actually benefit from increased capital costs.

Based on the demand for workers that this project will generate, Alaskans are obviously key to successful project execution. Both the State and the producers want Alaskans to benefit from the many job opportunities that will exist. When you consider carefully the options available, a producer pipeline will provide maximum value to the State of Alaska.

IMPORTANCE OF FISCAL STABILITY

For us to progress the project and mitigate its inherent risks, we do need some things from the State. Because of the nature and magnitude of the risks associated with this project – billions of dollars of financial commitments, unprecedented cost and scope, potential for construction delays, as well as the inevitable risks associated with the commodity price of gas - fiscal terms that are predictable and durable are necessary. As with all of our other mega-project investments, and we share this with the resource owners where those investments are to be made, we are willing to take geologic risks, we are willing to take cost risks, and we are willing to take commodity price risks, but we cannot take the risk of fiscal terms changing. Let me expand on this important concept further. The first two risks, geologic and cost risk are risks for which we have developed an industry leading expertise to manage. This is what we do day after day at EM. Market risk is inevitable in a commodity business such as oil and gas and we manage that by attempting to ensure that we deliver those products into the highest value market hub. Fiscal risk, however, is of a completely different nature and wholly outside of our control. We must have agreements that will allow us to develop this mega-project under predictable and durable terms, so that we can make an adequate investment decision. If fiscal terms can be changed in the future, then we are not able to make a well founded investment decision on behalf of our shareholders.

The Alaska Gas Pipeline Project will require massive investments to be made ten or more years before any revenue is generated from those investments. As a result, increases in taxes on oil and gas related activities during the life of the project could

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significantly impact the commercial viability of the project and offset the benefits of taking on a project of this magnitude. Because fiscal terms could be modified under the proposed AGIA legislation, it does not provide the fiscal stability necessary to ensure a commercially viable project.

Development of a predictable and durable fiscal framework means that the terms agreed between the Producers and the State recognize the magnitude and risks associated with the project; balance State and Producer needs; and provide for the calculation of total State take in a transparent and predictable manner.

SPECIFIC FEEDBACK ON AGIA

With that background, I would like to now give some feedback on AGIA which is based on the conclusions and principles I've mentioned. I will also outline our thoughts on how AGIA should be modified to provide the best chance of a successful result. For example, alignment between the State and the leaseholders is essential to a basin opening project of this magnitude. Therefore, establishing the right approach going forward is the most important activity for the project at this time. It is important that AGIA bring together the upstream and the midstream and provide for an integrated proposal. Let me expand on this point. The upstream and midstream at some point in time will have to come together. The reason is simple - the upstream pays for the midstream. When I say upstream I mean the revenue generated from sale of the gas and liquids from the pipeline project. To be able to calculate the revenue from the upstream we must have clarity on the taxes and royalty from our oil and gas operations and the taxes and royalties must be set at a level that makes the project viable. In order to ensure a viable project from the outset, we believe this must be done at the beginning.

At a minimum, any proposal should demonstrate how a successful open season would be achieved.

Also, it is important that AGIA allow applicants to define how they could achieve the State's key objectives rather than prescribing specific requirements that must be met. To ensure the best result, AGIA should establish broad key objectives and allow applicants flexibility in meeting those objectives by providing requirements they feel are necessary to make the project commercially viable. For example, we think it would be better to let the applicant determine whether or not they require any capital contribution from the State.

ExxonMobil recognizes the importance to the State, explorers and others of having access to the project so their gas can be treated and transported to markets. To ensure that a project is constructed, it must be commercially attractive to shippers at the time they make their initial firm transportation commitments. Shippers, particularly those who must invest substantially to explore for, develop and produce gas resources, will 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 initial rates will be significantly increased in the future in order to accommodate expansions.

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Under the Alaska Natural Gas Pipeline Act, Congress struck what it determined was the proper balance between encouraging investment by those willing to commit to pay for initial capacity and encouraging exploration by providing an opportunity for future access to the pipeline. Because of the unique nature of the Alaska gas pipeline project, FERC approved unprecedented policies to enable a FERC-mandated expansion to benefit explorers.

The issue of how potential future shippers may access initial capacity and future expansion capacity, if needed, should be administered by the FERC for all elements of the project in the United States. For example, shippers (producers) should not be required to subsidize other expansion gas holders (competitors) at 115% of initial maximum rates due to a mandated roll-in of expansion costs. For example this 15% increase could increase my FT commitment by 30 to 50 cents per MBTU on gas shipped. This is an increased cost of \$500 to \$800 million per year on the initial shippers. You could also consider this a subsidy to the expansion shipper. We are not in the business of subsidizing our competitors. This is too high of a risk to take. In addition, the pipeline entity should not be required to accept a FERC certificate irrespective of FERC imposed conditions.

As I discussed previously, with regard to upstream terms, the proposed upstream inducements would require significant modification to ensure a commercially viable project is obtained. It would be better to leave that issue open for now and allow an applicant to make a proposal to address those necessary terms.

AGIA also prescribes activities that must be completed within a specific timeframe or date certain. Setting arbitrary target dates is not consistent with good project management practices. Further, milestones are not necessary if the project is commercially viable. The producer's builder will progress the project at the maximum prudent pace, consistent with the industry proven "gate" process for project development.

In general, AGIA lacks specifics on key fiscal terms and other requirements. To address these gaps, AGIA gives commissioners broad authority to adopt additional requirements and establish regulations. Not knowing their requirements now creates significant uncertainty. AGIA also does not establish criteria for evaluating proposals and selecting the successful bidder, which is likely to lead to litigation from project proponents not selected for inducements.

Finally, because of the complexity and risk associated with this project, the parties must have an efficient and impartial means of handling disagreements when they arise. We believe project related agreements should provide for binding neutral arbitration as the mechanism for resolving disputes. Binding neutral arbitration is widely utilized in U.S. and international commercial agreements and is not a new concept with the State of Alaska. Arbitration is the method used to resolve disputes under the State's Royalty Settlement Agreements. In addition, Alaska courts have recognized a strong public policy in favor of arbitration.

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CONCLUSION

In closing, I would like to reiterate that ExxonMobil is committed to moving the gas pipeline project forward. Our company possesses the financial strength and project experience required to make this project a success. We are ready to work with the Administration and the Legislature to establish a framework that recognizes the integrated nature of the project and mitigates the risks I've discussed to allow the project to progress. We would suggest AGIA be amended to include the broad objectives the State wants to achieve and allow each applicant to decide how best to meet those objectives and to identify what is required from the State to advance the project. The State can then accept the proposal that delivers the most value. We are ready to participate in a competitive open transparent process under the approach I've outlined.

Thank you for your attention and for the opportunity to address this important topic today. I look forward to addressing your questions.

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Alaska Natural Gas Pipeline Project

Getting Alaska's Gas to Market

Senate Resources Committee

March 23, 2007



BP Key Messages



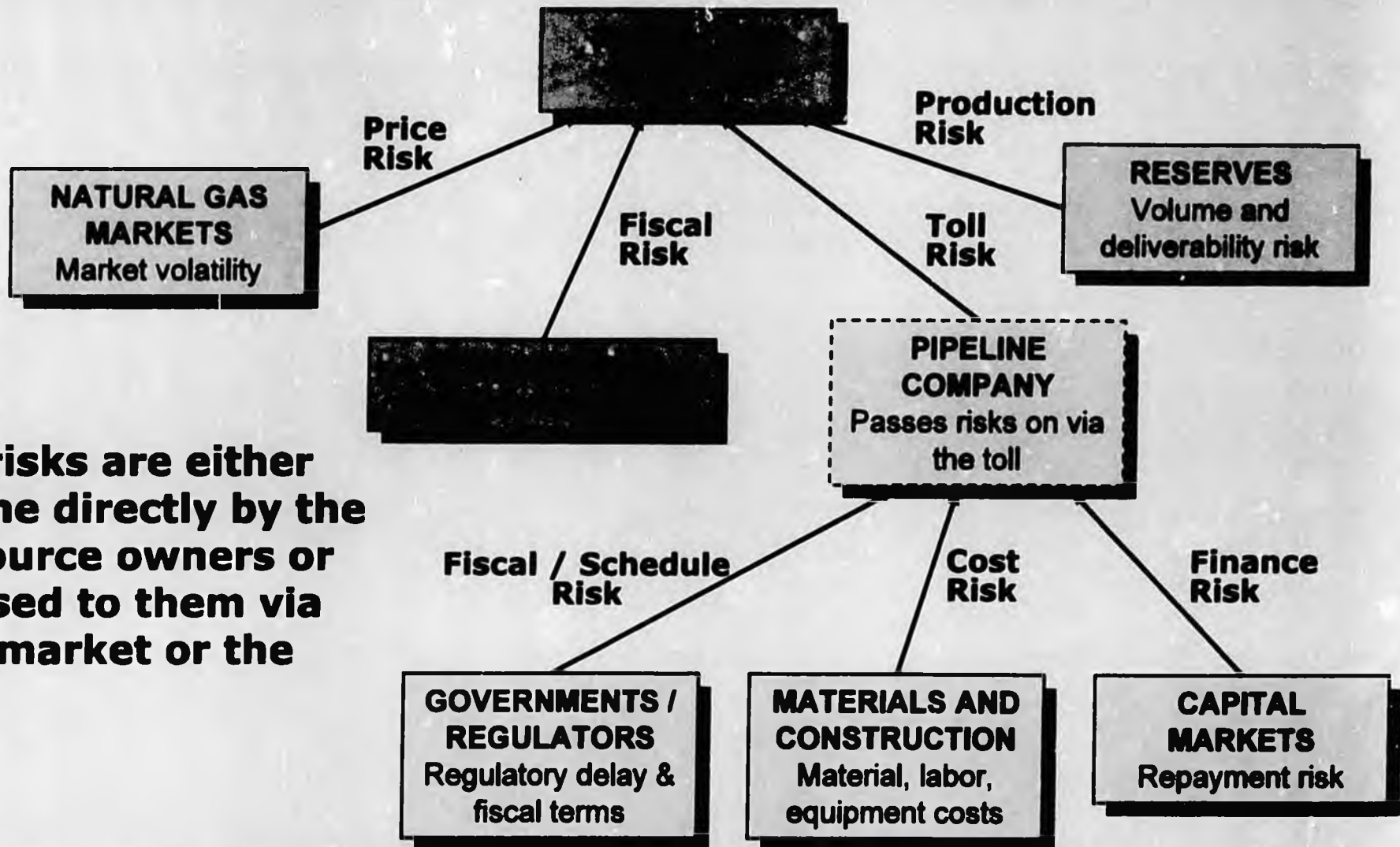
- **BP wants and needs a gas pipeline**
- **We support Governor Palin's desire to get Alaska's gas to market**
- **We are concerned that AGIA as drafted creates some unintended consequences**

Key Concerns to Address



- AGIA would result in an exclusive winner before any work is done; based on promises, not performance
- AGIA requires base shippers to subsidize expansion shippers, which adds risk to the pipeline
- Inducements could be suggested by project sponsors, rather than stipulated in advance
 - \$500m may attract underfinanced sponsors
- Solving resource issues with clarity enables a successful open season which is the key to advancing the project

Project Risk Residuals with the Resource Owners



All risks are either borne directly by the resource owners or passed to them via the market or the toll.



Those bearing a risk are commercially motivated to manage that risk

Summary



- BP wants and needs a gas pipeline
- BP supports an open and transparent process
- Upstream framework is critical
 - Must be addressed for a successful open season
- Key midstream issues must be addressed to ensure there are no unintended consequences
 - Granting an exclusive license before any work is performed prevents participation of others and reduces competition
 - "Inducements" should be based on performance, not promises

10 Largest Oil and Gas Pipeline Project Financings

(greenfield and expansion only – excludes acquisition financing and refinancings)¹

| | | | |
|----|--|---|--|
| 1. | Alliance Pipeline Project (Gas), Canada/US (3,000 km) | \$3.73 billion (\$2.59 billion debt) | Coastal, IPL, Williams, Fort Chicago Energy, Westcoast Energy |
| 2. | BTC Pipeline (Oil), Caspian Basin (1,730 km) | \$3.6 billion (\$2.59 billion debt) | Amerada Hess, BP, ConocoPhillips, Eni, INPEX, Itochu, SOCAR, Statoil, Unocal, |
| 3. | Cusiana – Cupiagua Pipeline (Oil), Colombia (800 km) | \$2.2 billion (\$1.54 billion debt) | Ecopetrol, BP, Total, Triton, TransCanada, IPL |
| 4. | Chad – Cameroon Pipeline (Oil), Chad (1,070 km) | \$2.0 billion (pipeline only) (\$700 million debt) | ExxonMobil, Petronas, Chevron |
| 5. | Bolivia-Brazil Pipeline Project (Gas) Bolivia / Brazil (3,075 km) | \$2.23 billion (\$1.4 billion debt) | Petrobras, BG, El Paso, YPFB, BHP, Enron, Shell |

¹ Also excludes primarily upstream projects with an integrated pipeline component. Based on Deazlogic database.

10 Largest Oil and Gas Pipeline Project Financings

(greenfield and expansion only – excludes acquisition financing and refinancings)¹

| | | | |
|-----|---|---------------------------------------|---|
| 6. | OCP Heavy Crude Pipeline (Oil) Ecuador (503 km) | \$1.2 billion (\$900 million debt) | Alberta Energy, Repsol, YPF, Occidental, Agip, Pecom Energia, Techint, Kerr- McGee |
| 7. | Mozambique-South Africa Pipeline Project (Gas), Mozambique (865 km) | \$1.2 billion (\$543 million debt) | Republic of South Africa, Republic of Mozambique, Sasol Polymers |
| 8. | Malhas Project (Gas), Brazil (expansion) | \$1.0 billion (\$900 million debt) | Petrobras, Mitsui, Itochu, Mitsubishi |
| 9. | Kern River Expansion II (Gas), United States (part refinancing) | \$875 million loan | Williams, Tenneco |
| 10. | Camisea (Gas), Peru | \$865 million (\$480 million debt) | Techint, Sonatrach, PlusPetrol, SK, Hunt Oil, Tractebel |

¹ Also excludes primarily upstream projects with an integrated pipeline component. Based on Dealogic database.

**BP Testimony on SB 104 (AGIA)
Senate Resources Committee
March 23, 2007**

- Mr. Chairman, members of the committee, for the record my name is Dave Van Tuyl. I am the Gas Commercialization Manager for BP Alaska. Thank you for the additional time to prepare our testimony, and for the opportunity to testify before you this afternoon.

BP Key Messages

- I'd like to start by emphasizing a few general points.
- **First, BP wants and needs a gas pipeline.** And we need that pipeline to be built for a low capital cost and then operated cost efficiently. We believe that is what is required to make the project happen and be successful. Low costs are good for both BP and the State because it results in lower tariffs, higher netbacks and more revenues for the State and BP.
- Also, a low cost project will provide incentive to explore for more gas to keep the pipeline full into the future. That is also good for the State and for BP.
- The best way to ensure there is gas exploration in the future is to get a gas pipeline built in the first place, and to get it built for a low cost.
- **This is a hugely important project to BP, to Alaska and to the nation.** It represents the largest, known, undeveloped gas resource in the United States, and in BP's global portfolio. The gas project is important in its own right – but it also extends the economic life of Alaska's oil production for decades. Extending oil production is good for the State, the nation and for BP.

- **Second, we share the governor's and the legislature's desire to get a gas project moving, and BP stands ready to engage with the administration and legislature to reach a balanced fiscal framework that works for all the parties.**
- **And finally, a successful framework will set the foundation for a stable, healthy, and viable oil and gas business for decades to come. BP's future in Alaska is directly linked to the gas pipeline project.**
- **That's why we are very encouraged by the Governor's and the legislature's enthusiasm about getting Alaska's gas to market. That is also our vision, and so we share your enthusiasm. It's the key to Alaska's future, and to BP's future in Alaska.**
- **Therefore, it's important that we get it right.**
- **BP sees AGIA as the Administration's expression of its commitment to advance the gas pipeline project in an open and transparent way. We applaud that good faith expression.**
- **Developing the right process is difficult. Since first seeing AGIA at its roll out on March 2nd, we have identified a number of important areas of concern for you to consider.**
- **We believe AGIA may create some unintended consequences that could jeopardize the vision of getting Alaska's gas to market quickly, and at low cost. We believe it is important for the Legislature to consider these areas of concern as you deliberate on AGIA.**
- **Next I'd like to turn your attention to a few of those key areas of concern with the current AGIA bill.**

Key Concerns

- **The first concern is that AGIA would result in an exclusive winner before any real work is done and awards State funds based on promises, not results**
 - **We think it wise that the State consider avoiding any notion of exclusivity or the government 'picking a winner': I'm not aware of any example where that has worked successfully.**
 - **We recognize that the Administration has, in good faith, laid out selection criteria to enable the selection of the exclusive winner in as transparent a way as possible.**
 - **We believe that the State can help to advance the project by setting out a clear framework for investors - from there the market will work to identify the most effective project**
 - **And we support open competition in the marketplace, rather than in advance of actual performance or before the competition actually starts**
 - **In fact, the FERC requires that the market demonstrate that it wants that application before awarding a certificate to an applicant. That's what happens in a successful open season.**
 - **We certainly understand that from the State's perspective, there are a number of specific things desired from ANY project (jobs and training for Alaskans, gas access for Alaskans, pipeline expansions).**
 - **We support all of these objectives.**
 - **Those objectives can and will be addressed by a successful project through open competition in the marketplace.**

- **The second concern is that AGIA as drafted can result in one party subsidizing another. AGIA specifically requires initial shippers - who financially underpin the project and who already bear most of the risk associated with the project - to bear yet another risk and additional cost: the risk of tariff increases of 15% or more by subsidizing expansion shippers**
 - **We understand and we fully share the State's desire for a pipeline to be expandable - it's absolutely good business.**

- However, we believe that the **State should carefully consider the potential adverse consequences of requiring pipeline owners to increase rates on their initial customers to subsidize expansion shippers.**
- A policy of subsidization places additional risk on the initial shippers, making the project less attractive, and therefore puts the project at risk.
- Now if the **State wants to subsidize others**, it can certainly do so itself, directly, as a policy choice. But we don't believe it's good policy to do so with other peoples' money.
- Congress made clear in the Alaska Natural Gas Pipeline Act of 2004 that rates for initial shippers should NOT increase if a mandatory expansion was ordered. In fact, the language of the Federal Law states that

"the [FERC] shall...ensure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers." - ANGPA, Sect. 105(b)

- Also, in Order 2005, FERC put in place a rebuttable presumption of rolled in rates for expansions provided it did not require subsidization by initial shippers [and I'd like to read paragraph 125 of the Preamble]:

"In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the Commission intends to harmonize both objectives (rate predictability for initial shippers and reduction of barriers to future exploration and production) in designing rates for future expansions of any Alaska natural gas transportation project. It is consistent with our guiding principle that competition favors all of the Commission's customers, as well as with the objectives of the Act, to adopt rolled-in rate treatment up to the point that would cause

there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found." [Order 2005, paragraph 125]

- These two excerpts from Federal law and regulation, suggest that AGIA and Federal law could be in conflict. This conflict issue actually becomes quite complicated, and we are continuing to study it. If indeed there is a conflict, resolving it would add delay and uncertainty. We do not see how that is in any of our interests.
- We heard FERC testify yesterday and speak very favorably about the bill, but this area of conflict was not specifically addressed. So in fact, we plan to consult with FERC in the very near future just to ensure there is not a conflict problem in the future.
- In any case, we believe that this type of provision, requiring a subsidy for not-yet-ready shippers at the expense of initial shippers, would be a disincentive for potential shippers participating in an open season. That's also not in any of our interest.
- And for the record, I just wanted to ensure that the nature of the producers' challenge to Order 2005-A was clear. We are only challenging the issue of whether or not FERC should be able to dictate design changes after the conclusion of an open season. We are not challenging the rebuttable presumption of rolled-in rates provided it does not result in a subsidy. A contrary statement was made earlier in the week, and we wanted to ensure that we made that point clear.
- Our motivation for the challenge is to prevent cost increases, and to avoid unnecessary project delay.

- **A third area for careful consideration, and perhaps the centerpiece of AGIA, is the \$500 million grant**
 - I would like to be clear, this was not requested by BP
 - It may be attractive to underfinanced project sponsors or companies not willing to risk all of their own money
 - **Rather than specifying in advance what inducements are needed, the State could ask project sponsors to propose specific midstream inducements – this gives the free market opportunity to do what it does best**
 - The State could then determine what inducements to offer and make them available to all parties
 - We've heard the Administration say that the \$500m is provided up front because this is the riskiest phase of the project. We have a very different view.
 - The up-front phase is risky for a non-resource owner who is not confident that it will have customers participate in its open season; we heard Enbridge share this view last week. But the riskiest phase for the ultimate shippers in fact is the construction period – where cost control is critical, and will be the key determiner of what the ultimate toll will be.
 - In fact, as we've previously shared, ALL project risks ultimately flow to the resource owners who make those initial firm transportation commitments, which I'll discuss in more detail shortly.

- **A fourth area we suggest be considered carefully is that, although AGIA seeks to get a project moving, and we fully support that objective, it does not sufficiently address the resource framework, which is the key enabler for a financeable project**
 - It is widely understood that the resource owners will pay the cost and bear the risk in building a pipeline **whether they own it or not**

- **Resource owners will pay all the costs of the pipeline, either directly or indirectly by reimbursing the pipeline owner through the tariff for the costs they incur**
- **Multi-billion dollar commitments spanning decades are needed to financially underpin this project;**
- **Just like Wall Street needs to know the rules before lending money, resource owners need to know the fiscal rules that will govern the project before making commitments that will enable the pipeline to be financed.**
- **Although this is widely known, the details of an upstream framework are complex and take time and effort to agree - but unless they are addressed, a project won't secure financing; it won't advance**

Risk Diagram

- **This next slide attempts to show how risk is ultimately allocated in a major resource development project like the Alaska Gas Pipeline Project**
- **I'm going to step through it one bit at a time.**
- **First, we start with the Resource Owners – that's of course the State of Alaska, and it includes the lessees, like BP, CP, EM, Chevron and others.**
- **There are certain risks that are inherent to the resource itself.**
 - **There is always price risk associated with selling a commodity like gas**
 - **that's the risk that the price of gas will fall in the future, possibly below the tariff**
 - **There's also production risk**
 - **Keeping the pipeline full for project life**
 - **Being able to deliver the full volume every day**

- **These risks are important considerations when a resource owner has to make the firm transportation commitments necessary to underpin the project**
- **Next, there's fiscal risk for a lessee, that's the risk that the fiscal terms on the upstream business might change. On major infrastructure projects like this around the world, it's not uncommon for host governments to address fiscal risk with a mutually agreed framework.**
- **There are also a whole host of risks associated with constructing the pipeline itself**
 - **Regulatory process could change → schedule risk**
 - **Material, labor and equipment costs → cost risk**
 - **Need for finances from the capital markets → finance risk**
- **Just to put the finance risk in perspective, I have this handout that my finance folks sent me yesterday that summarizes the 10 largest oil and gas pipeline project financings ever.**
- **You'll notice that the largest financing to date is \$3.7 billion, which is a fraction of the anticipated cost of this project. I thought this might be useful context for the committee.**
- **All these project-related risks that are taken by the pipeline company are ultimately passed through to the resource owners through the toll**
 - **The Pipeline company receives a regulated rate of return**
 - **Gets a limited but reasonable return on investment, come rain or shine**
 - **That's the pipeline's reward**
 - **In exchange for this regulated rate of return, the regulators ensure that the pipeline does not take on certain risks**

- These instead are passed through to the resource owners
- That's how the risk / reward balance is struck by the pipeline regulators
- So ultimately, **ALL RISKS** are either borne directly by the resource owners, or are passed through to the resource owners through the toll
- To ensure a low cost project, it's important that those that are bearing a risk are able to manage that risk
 - They are commercially motivated to manage that risk downwards
- To reiterate, it's critical that the fiscal system is established in such a way that the risks associated with the resource or "upstream" are adequately addressed to ensure the risk / reward balance is right.
 - That will maximize the likelihood of having a successful open season and a successful project.
 - The State is uniquely positioned to address this risk

Summary

- So in summary, I'd like to leave you with four messages.
- First, BP wants and needs a gas pipeline. It's critical to our vision of the 50-year future in Alaska.
- Second, BP fully supports an **open process** that leads to a mutually agreed fiscal framework with the State that **allows a project to advance and attract financing**
- We think there should be an **open and transparent public review** of the resulting framework

- **The Governor has already committed to keep the legislature and the public apprised - we fully support her in that.**
 - **It is critical that the legislature supports and endorses that framework**
 - **The judicial branch should review that framework to ensure constitutionality**
 - **The people of Alaska and all 3 branches of government should and will be consulted.**
- **We think that the resulting framework should be available to all investors to ensure competition**
 - **Third, mutually agreeing an upstream framework is critical. The resource issues must be resolved for the project to proceed and to ensure the resource owners have sufficient confidence to make the necessary long term financial commitments in an open season required to advance the project. We are ready to engage on developing that upstream framework.**
 - **And fourth, we believe that a number of midstream details in AGIA should be fixed.**
 - **any notion of exclusivity or the government 'picking a winner' should be avoided**
 - **Any process should allow competition in the marketplace to work**
 - **Finally, any payment of State 'inducements' should be made after promises are delivered, not before**
 - **For example, we think it would be appropriate that a sponsor earn inducements by actually conducting a successful open season that results in firm transportation commitments, rather than before actual results are delivered.**
 - **It is easy to make hopeful promises**
 - **but it is harder, and vitally important, to deliver performance**

- That is what we believe the State should require. **Delivery, not promises.**

- Thank you for the opportunity to testify today. I'd be happy to answer any questions you might have.
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**Response to Questions Raised by Senate Resources Committee
Following Testimony Provided by BP Exploration's
Gas Commercialization Manager David Van Tuyl
at March 23, 2007 SB 104 AGIA Hearing**

1. Is there anything in the PBUOA that would prevent one owner from participating in an open season if the others didn't choose to?

No. Strictly speaking, at an open season a company makes a financial commitment to pay demand charges for firm transportation services, and is not committing gas directly to the pipeline. No provision of a unit agreement would prevent a company from choosing to commit its funds at an open season. However, it is reasonable to expect that that company would only make that commitment if it was sufficiently certain that it could actually deliver the volume of gas that corresponds to the firm transportation services it was seeking to acquire.

Although one owner could participate in an open season if the other owners did not, the owner would not likely participate unless the owner could actually deliver gas to the proposed project in compliance with the applicable unit operating agreement and any applicable other agreements. Whether the owner could comply with those agreements would depend on the terms of those agreements, which vary unit by unit, and the circumstances surrounding the delivery of gas. For example, the provisions for taking gas under the Prudhoe Bay Unit Operating Agreement (PBUOA) are quite complex and, before any owner in that unit would participate in a binding open season, an exhaustive analysis of the entire agreement would be undertaken as well as analysis of any other applicable agreement. In short, before an owner could take gas for a major gas sale, some agreements among the owners would likely be required.

In sum, before an owner individually would participate in an open season, the owner would want to ensure that all conditions necessary in the applicable operating agreement and other agreements for the taking of gas production and delivery of that gas to a pipeline may be satisfied. That may require additional agreements among the owners depending on the circumstances.

We plan to conduct a more complete analysis of the PBUOA and offer a response when that analysis has been completed.

2. What percentage of your total company's gas production would this project represent?

In 2006, BP produced 1.45 million barrels of oil equivalent in gas (~8.4 bcf/d). Therefore, if BP's share of gas provided to a 4.5 bcf/d Alaska gas pipeline project was 1 bcf/d BP net, Alaska gas would represent just over 10% of BP's total worldwide gas production.

in abeyance, then a conditioning service will have to be included as a part of the open season, but again, with all services offered priced separately."

The FERC does not specifically address the issue of the rate treatment of a GTP expansion (that is, whether the rate would be incremental or rolled-in).

- 4. Please provide additional information on the "Top 10 Oil and Gas Pipeline Project Financings" chart provided to the Committee, including dates of projects and cost information if available. Also, why is TAPS not included on the list?**

The summary provided to the Committee is a listing of the 10 largest oil and gas pipeline project financings, not necessarily the largest projects. TAPS is not included in the table because it was not project-financed. For reference, project financing is when lenders look to the revenues generated by the project itself for repayment of monies loaned.

We are continuing to attempt to compile the additional details requested by the Committee and will provide a more detailed response once that information is available.

- 5. What is the volume of liquids that will be carried in the gas pipeline?**

The total volume of liquids carried in the Alaska gas pipeline project at any point in time is dependent on a number of factors, including the inlet volume of gas delivered to the pipeline, the heating value or "richness" of the gas delivered, the disposition of ethane (which can be marketed as either gas or liquid) and the operating temperature and pressure of the system.

Assuming an inlet gas rate of 4 bcfd, heating value of 1080 btu/mcf, with the pipeline operating at 2500 psi with a 30 degree compressor discharge temperature, the total liquids potential is approximately 180,000 barrels per day, of which approximately 100,000 barrels per day is ethane.

CORRECTION

**THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION**



Rev. 6/98

Central Microfilm Services
Department of Education & Early Development
State of Alaska

**Response to Questions Raised by Senate Resources Committee
Following Testimony Provided by BP Exploration's
Gas Commercialization Manager David Van Tuyl
at March 23, 2007 SB 104 AGIA Hearing**

1. Is there anything in the PBUOA that would prevent one owner from participating in an open season if the others didn't choose to?

No. Strictly speaking, at an open season a company makes a financial commitment to pay demand charges for firm transportation services, and is not committing gas directly to the pipeline. No provision of a unit agreement would prevent a company from choosing to commit its funds at an open season. However, it is reasonable to expect that that company would only make that commitment if it was sufficiently certain that it could actually deliver the volume of gas that corresponds to the firm transportation services it was seeking to acquire.

Although one owner could participate in an open season if the other owners did not, the owner would not likely participate unless the owner could actually deliver gas to the proposed project in compliance with the applicable unit operating agreement and any applicable other agreements. Whether the owner could comply with those agreements would depend on the terms of those agreements, which vary unit by unit, and the circumstances surrounding the delivery of gas. For example, the provisions for taking gas under the Prudhoe Bay Unit Operating Agreement (PBUOA) are quite complex and, before any owner in that unit would participate in a binding open season, an exhaustive analysis of the entire agreement would be undertaken as well as analysis of any other applicable agreement. In short, before an owner could take gas for a major gas sale, some agreements among the owners would likely be required.

In sum, before an owner individually would participate in an open season, the owner would want to ensure that all conditions necessary in the applicable operating agreement and other agreements for the taking of gas production and delivery of that gas to a pipeline may be satisfied. That may require additional agreements among the owners depending on the circumstances.

We plan to conduct a more complete analysis of the PBUOA and offer a response when that analysis has been completed.

2. What percentage of your total company's gas production would this project represent?

In 2006, BP produced 1.45 million barrels of oil equivalent in gas (~8.4 bcf/d). Therefore, if BP's share of gas provided to a 4.5 bcf/d Alaska gas pipeline project was 1 bcf/d BP net, Alaska gas would represent just over 10% of BP's total worldwide gas production.

3. What does Order 2005 say about regulation of the GTP? Would the rate resulting from a GTP expansion be rolled-in or incremental?

In Order 2005, FERC requires that regulations for a GTP provide for an "unbundled" service, that is, that the gas treatment service must be offered separate from the gas transportation service. This would allow a shipper to choose between the services offered. The FERC's statement is summarized in paragraph 128 of the preamble to Order 2005:

"The Commission is stating in the final rule at section 157.34(c)(6) that the open season notice must contain an unbundled transportation rate. Moreover, section 157.34(c)(10) prohibits a prospective applicant from requiring prospective shippers to process or treat their gas at any designated facility. The Commission is satisfied that it can address any other discriminatory conduct in connection with gas quality requirements or other ancillary services through the provisions of section 157.35 in conjunction with existing Commission policies and procedures."

Additional details as to the FERC's requirements related to a gas treatment plant are specified under Order 2005-A. Specifically, under paragraph 87:

"The Commission did not intend to preclude the inclusion of jurisdictional natural gas conditioning facilities from the open season. If, pursuant to ANGPA section 103, a project sponsor intends to file an application under section 7 of the NGA for authorization of a project that includes a jurisdictional natural gas conditioning service, we will review the open season plan and notice to ensure that such service is offered in its open season notice, subject to the same requirements as apply to transportation service. However, the prospective applicant must offer a separate rate for the gas treatment service and separate rate for the transportation service. Furthermore, the prospective applicant can neither require bidders to bid on both services, nor evaluate the bids based on whether bidders requested one or both services. Moreover, while the prospective applicant can require specific natural gas quality specifications such as would be met by using the conditioning services offered, it cannot reject an otherwise qualified bidder that states that it will deliver to the pipeline facilities gas that meets the stated quality specifications."

The Order continues, in paragraph 88, to address the inclusion of a gas treatment plant into the ANGTS design, which originally excluded a GTP:

"On the other hand, if a prospective applicant is proposing to apply to revise the Alaska Natural Gas Transportation System (ANGTS) application now held

in abeyance, then a conditioning service will have to be included as a part of the open season, but again, with all services offered priced separately."

The FERC does not specifically address the issue of the rate treatment of a GTP expansion (that is, whether the rate would be incremental or rolled-in).

- 4. Please provide additional information on the "Top 10 Oil and Gas Pipeline Project Financings" chart provided to the Committee, including dates of projects and cost information if available. Also, why is TAPS not included on the list?**

The summary provided to the Committee is a listing of the 10 largest oil and gas pipeline project financings, not necessarily the largest projects. TAPS is not included in the table because it was not project-financed. For reference, project financing is when lenders look to the revenues generated by the project itself for repayment of monies loaned.

We are continuing to attempt to compile the additional details requested by the Committee and will provide a more detailed response once that information is available.

- 5. What is the volume of liquids that will be carried in the gas pipeline?**

The total volume of liquids carried in the Alaska gas pipeline project at any point in time is dependent on a number of factors, including the inlet volume of gas delivered to the pipeline, the heating value or "richness" of the gas delivered, the disposition of ethane (which can be marketed as either gas or liquid) and the operating temperature and pressure of the system.

Assuming an inlet gas rate of 4 bcfd, heating value of 1080 btu/mcf, with the pipeline operating at 2500 psi with a 30 degree compressor discharge temperature, the total liquids potential is approximately 180,000 barrels per day, of which approximately 100,000 barrels per day is ethane.

ALASKA STATE LEGISLATURE

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



State Capitol, Room 119
Juneau AK 99801-1182
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Senate Resources Committee

Senate finance Room 532

Saturday, March 24, 2007

AGENDA

- **SB 104 – Natural Gas Pipeline Project**
"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

1:00 – 3:00

Joint Senate Resources and House Special Committee on Oil & Gas

Public Testimony

Time Limit May Be Set

3:00 – 5:00

Senate Resources Committee

ConocoPhillips

Wendy King, Director, State Negotiations

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

March 24, 2007

2:50 p.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Lyda Green
Senator Lesil McGuire
Senator Bill Wielechowski
Senator Thomas Wagoner

MEMBERS ABSENT

Senator Bert Stedman, Vice Chair
Senator Gary Stevens

OTHER LEGISLATORS PRESENT

Representative Ralph Samuels
Representative Vic Kohring

COMMITTEE CALENDAR

SENATE BILL NO. 104

"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 104

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

| | | |
|----------|-----|---------------------------------|
| 03/05/07 | (S) | READ THE FIRST TIME - REFERRALS |
| 03/05/07 | (S) | RES, JUD, FIN |
| 03/14/07 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 03/14/07 | (S) | Heard & Held |
| 03/14/07 | (S) | MINUTE (RES) |
| 03/16/07 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 03/16/07 | (S) | Heard & Held |
| 03/16/07 | (S) | MINUTE (RES) |

| | | |
|----------|-----|---|
| 03/19/07 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 03/19/07 | (S) | Heard & Held |
| 03/19/07 | (S) | MINUTE (RES) |
| 03/21/07 | (S) | RES AT 3:30 PM SENATE FINANCE 532 |
| 03/21/07 | (S) | Heard & Held |
| 03/21/07 | (S) | MINUTE (RES) |
| 03/21/07 | (S) | RES AT 5:30 PM SENATE FINANCE 532 |
| 03/21/07 | (S) | Heard & Held |
| 03/21/07 | (S) | MINUTE (RES) |
| 03/22/07 | (S) | RES AT 4:15 PM FAHRENKAMP 203 |
| 03/22/07 | (S) | Heard & Held |
| 03/22/07 | (S) | MINUTE (RES) |
| 03/23/07 | (S) | RES AT 1:30 PM BUTROVICH 205 |
| 03/23/07 | (S) | Presentation: Industry Representatives |
| 03/24/07 | (S) | RES AT 1:00 PM SENATE FINANCE 532 |
| 03/24/07 | (S) | RES AT 3:00 PM SENATE FINANCE 532 |

WITNESS REGISTER

WENDY KING, Director
 State Negotiations
 ConocoPhillips Alaska, Inc.
 Anchorage AK 99510

POSITION STATEMENT: Commented on SB 104.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at 2:53:17 PM. Present at the call to order were Senators Wagoner, McGuire, Green, Wielechowski and Huggins. Representatives Kohring and Samuels joined the committee.

^#SB104

SB 104-NATURAL GAS PIPELINE PROJECT

CHAIR HUGGINS announced SB 104 to be up for consideration and that the committee would first receive comments from Wendy King.

[The following is a verbatim transcript of Ms. King's comments]

WENDY KING, Director of State Negotiations, ConocoPhillips Alaska, Inc.: I work for ConocoPhillips in Anchorage and I

have been working on the ANS gas development project for four and a half years. I'm pleased to be here today to testify on SB 104 or the proposed AGIA bill. And I'd highlight - I think there are some handouts or some presentation materials and rather than work off the screen, we're going to work off the handout. I'll try to do my best to try to follow you through, even though there's not slide numbers on here. I'll do my best to draw your attention to the different points in the slides.

Before I discuss the bill and we'll turn to that first slide labeled "Investing in Alaska Today" I want to reintroduce to the committee ConocoPhillips and what our business in Alaska looks like. ConocoPhillips is the state's largest oil and gas producer. We have had 1,200 uninterrupted LNG shipments since 1969 from the Kenai LNG plant. We are the state's largest acreage holder on the ANS and we have drilled over 60 exploration wells since 1999. We have drilled 16 wells in NPRA where we're the operator.

ConocoPhillips - I get to learn these little facts about my company all the time - but one of them was that ConocoPhillips' heritage company, Phillips, was the first oil company to establish an office in Alaska.

Just to move on to some general comments, I wanted to emphasize that timing on this project is important. I would agree with the administration that the timing is an important issue. Our company is committed to developing the ANS gas resources and ConocoPhillips is willing to consider creative solutions. We are eager to find a framework by which both parts of the project, both the midstream and the resource parts of the project, can be advanced. And I want to step back for a second and define that.

The midstream sides of the project - and I'm going to use that term quite a bit - for me it involves what we call the gas transmission lines, the gas treatment plant, the big pipe that would go to Alberta and then what the different alternatives might be from Alberta to markets in the Lower 48. So, all components of that I would call the midstream portions of the project.

Upstream are the resource portions of the project or the assets that would be asked to be making shipping commitments to the project - so assets like the working

interest owners in Prudhoe Bay or NPRA or other exploration. So, it's more from the perspective of a resource owner - a working-interest owner. That's the terminology I'll use.

2:53:26 PM

The next slide in your packet is what makes the Alaska project different. And what you've got here is a graph of the North American gas pipeline projects that have happened since 1997 that are greater than \$100 million. And I think from a visual perspective, the first thing eyes always go to when we look at this graph is that the cost of the Alaska gas pipeline project is just off the scale. I mean this has got the \$20 billion 2001 estimate on it. But you can see, here's the Rockies Express Project, a pipeline project that is in construction right now. Its estimated cost for a 1,300 mile pipeline is \$4 billion. The Alliance project which was completed in December of 2000, is a 1.3 bcf/day pipeline cost around \$3.6 billion and it's an 1,800 mile pipeline. Mac Delta, I'm sure most of you have read, the MacKenzie Delta project - the cost increases that are just incurred on the MacKenzie Delta project - I believe the public estimate that was just made on that is \$14 billion including the upstream development - that's U.S. dollars and that's a 1.2 bcf/day project. So just a flag - you know the Alaska gas pipeline project being a 3,600 mile pipeline with a cost estimate greater than \$20 billion is just not comparative of these. It's much bigger. The scale is significantly larger.

And I would also highlight that comparing - you know, you can't just take and say it's a \$30 billion project or a \$20 billion project, whatever the number ends up being - and say that's 10 times \$2 billion projects.

2:54:14 PM

The scale is just different. You can't just multiply it out. The next point I would like to make was on...

SENATOR WIELECHOWSKI: Since the cost is so much for this - how many miles did you say it was?

MS. KING: It's 3,600 miles from Alaska's North Slope to Chicago, which would be one of the markets in the Lower 48.

SENATOR WIELECHOWSKI: Since that is - 3,600 miles - doesn't it make sense to start maybe thinking a little bit more

about building a simply 800-mile line down to Valdez and shipping it by LNG?

MS. KING: Senator Wielechowski, through the Chair, actually that is a question that ConocoPhillips, being the current operator and have had an existing LNG operation in Alaska for decades, it's a question we consistently look at. And we still believe that the cost - you'd still have to build a 800-mile pipeline - you'd still have to have the gasification, tankers, move it to a market and get it to it - a disadvantaged market in the context of you can only access the coast and have to bring it in. We still believe the total costs are better going with a pipeline project through Canada to the Lower 48. So, we've looked at it; we continually look at it; we think we bring a unique perspective on that. We have proprietary technology on LNG and we still believe the cost is better to go with a pipeline project to markets in the Lower 48 through Canada.

2:56:46 PM
The next slide, if you turn to - and this is - you know, predicting natural gas prices - it's a risky business. And this graph is actually to just highlight a quick critical point here. What you've got on here is the forward curve that was published on December 9, 2005. That's the black line on this graph. And what's underneath it is what the actual gas prices were over the course of that year. So for me, I find this quite a staggering graph in that it kind of grounds me that we can't even predict natural gas prices within a one-year timeframe. Can you imagine trying to do that for a 30 or 40 year timeframe? And that's one of the key risks that the resource owners bear in this project - is that the volatility and the uncertainty on natural gas prices.

I'd also like to highlight that ConocoPhillips wants to work with the Alaska legislature and Governor Palin on a framework that will advance a project. We agree a public transparent process is needed and we also believe a balanced deal is needed to stand the test of time. The project is just too big to have a winner/loser mentality. We've got to find a balanced deal to go forward.

We believe ConocoPhillips can bring a lot of value to this project. We have financial strength; we have Arctic experience; we have Alaska experience; we operate in

Alaska. We have project management skills and we have mega-project skills and we have key learnings from other pipeline projects that we're involved in. We also believe we bring a unique perspective to this in that we are an existing producer, but we are also an explorer. We have a track record of trying to advance the Alaska gas pipeline project and we have spent millions of dollars trying to do that.

My primary focus today is to convey that we want to work in a constructive way with you to move forward, but more work is needed. The first time ConocoPhillips saw the proposed bill was on March 2, which was the first day it was released to the public. We have had our teams reviewing the bill and are eager to find a framework that will allow development of ANS gas resources to advance. We need to be able to work through some critical issues with the Alaska legislature and Governor Palin. We are not locked into the old proposal, but we need to find a framework that addresses the critical resource issues that are needed to support long-term shipping commitments for this project.

One aspect of the proposed bill that we have noted in particular is the distinction between the midstream and the resource terms. The risk/reward balance is very different between the regulated return portions of the project, particularly when they're backed by strong firm transportation agreements. Just to remind people, firm transportation agreements are those agreements where a shipper would be asked to pay a pipeline what is called a demand charge, day in/day out. And for a project of this magnitude, it could be 20 - 25 years that people are asked to sign that shipping commitment for. And I'd point out as well - you pay for that charge regardless if you ship gas or not.

The split between the midstream and that resource we think will help to illustrate the differences on risk and reward within the project. That being said, the project will only be successful if both the midstream and the resource risks are addressed.

Based on our initial review of the bill, ConocoPhillips has four key question areas that we would like to discuss with you. We have some suggestions on some of these, but we still don't have solutions for all of these. The four key

areas are first - exclusivity or what we would call creating roadblocks to alternative projects; the second one is the resource terms, themselves; the third one, we'll buck it, is called the midstream bid requirements; and the fourth one is the expansion terms. And I'll go into more detail now on these four areas.

Exclusivity or roadblocks to competing projects - I'd first like to flag a key question - Why would the state want to block alternative projects instead of letting the free market work most efficiently? And I want to draw your attention to section 440 in the bill.

CHAIR HUGGINS: I'm sorry, Wendy, would you say which section again?

MS. KING: Yes, Chairman Huggins, section 43.90.440. This particular section reads:

Except as otherwise provided in this chapter, the state grants the licensee assurances that the licensee has exclusive enjoyment of the inducements provided under this chapter.

CHAIR HUGGINS: Okay, hold on just a second. Okay - page 18, line 22 - we're now prepared.

MS. KING: Sorry chairman Huggins. I was reading from line 22 and I'll read that again.

Except as otherwise provided in this chapter, the state grants the licensee assurances that the licensee has exclusive inducements - 'Excuse me, I can't read today - Oh, jeez, it's been a long week - I apologize - starting over again.'

Except as otherwise provided in this chapter, the state grants the licensee assurances that the licensee has exclusive enjoyment of the inducements provided under this chapter. If the state extends to another person preferential royalty, tax, or monetary treatment for the purpose of facilitating the construction of a competing natural gas pipeline project in the state, and if the licensee is in compliance with the requirements of the license and with the

requirements of state and federal statutes and regulations relevant to the project, the licensee is entitled to payment from the state of an amount equal to three times the total of reasonable costs that the licensee has incurred in developing the licensee's project as of that date that the state first extended preferential treatment to another person.

Then I'd like to draw your attention to sections 340 in the bill and I'll try to find the pages here for you.

Actually sections [43.90.]330 and 340, I'm particularly looking at what the inducements are on pages 16 and 17 in the bill. The midstream inducements include streamline coordination for the project. Why wouldn't the state offer the benefits of streamline coordination to any project? That is how the federal process is set up.

The inducements and particularly in section 340(b), line 7, indicate that the inducements - you can not put burdens - and I recognize that is a word I am using, but you can read your own words there - on a permit by any state agency would only apply to the licensed project. Does that then mean that the state would be willing to put burdens on a competing or alternative project through the permitting process? The way the bill is currently conceived, it would from a practical perspective make it incredibly difficult to permit an alternative project with the state for potentially as long as ten years. It is not clear what that the state could ever provide streamline permitting to any other project without creating litigation exposure to the original licensee.

The exclusive inducements also include the benefits of a state-funded training program for Alaskans. Why would the state be willing to train Alaskans for only one project - the licensed project? Shouldn't qualified Alaskans have the opportunity to be trained and work on any project that is being advanced by mixing streamline permitting, the office of the state coordinator - AGIA coordinator, training for Alaskans and creating obstacles to work with resource owners except with regard to the licensed project with exclusive inducements of AGIA, it becomes difficult to see...

CHAIR HUGGINS: Wendy, could you please give us a page and which line you're on.

MS. KING: Oh, I'm skipped ahead in the bill, but I'm back on 440 and I'm kind of closing in this section here.

CHAIR HUGGINS: Yes, when you do that if you would just give us a page and line number, it would help us.

MS. KING: I apologize, Chairman Huggins.

Section 440 again - and I'm going to draw in here...

SENATOR WAGONER: Page?

MS. KING: Page 18, line 22 through 31 again. I'm back to the reference to the exclusive inducements and also the treble damages clause.

The exclusive inducements - they include the benefits of streamline permitting - that's listed in the bill, the office of the AGIA coordinator - the state coordinator, training for Alaskans, and creating obstacles to work with resource owners except with regard to the licensed project. It becomes difficult to see how an alternative project could be advanced anytime over the next ten years unless the licensee agrees that the project is uneconomic or if there was an arbitrator's award saying that it was uneconomic, that that was not challenged by the licensee.

I want to emphasize, ConocoPhillips is a supporter of streamlined permitting. We worked very hard on the federal legislation that was passed with the Alaska Natural Gas Pipeline Act. If the state is going to pass similar provisions, we believe they should be available to any project that is being advanced.

We request that these sections be amended to make it clear that other projects can advance. So that is particularly the focus in those sections of 440 on page 18 and I'll go back on pages 16 and 17 to the inducements associated with the Alaska Gas line Inducement Act coordinator. So that's our first area of...

SENATOR MCGUIRE: Wendy, on that point. So you know the theory behind these inducements if you will and the exclusivity of them is to get the project going. To incentivize people who have been similarly situated over the last three decades, two decades, depending on how you argue it and yet nothing seems to be moving forward. So would your argument be that these incentives aren't needed? Or I guess what I'm trying to - and I don't disagree by the way. I'm very concerned about the treble damages associated with that section because I think that a lot of those inducements are things we'd like to offer to anybody that's willing to develop resource development projects in Alaska.

But I guess my question is, do you think these inducements are needed in the exclusivity and if not, what is the alternative?

MS. KING: I do believe there are value in these inducements. I believe that streamline permitting - I believe that the state helping with the training program - Labor is clearly going to be a challenge for these projects so I do believe that there are value in these inducements. My concern stems, again, the exclusive nature of the inducements. So I do believe - and I understand your concern of wanting to motivate a gas pipeline project going forward.

And I believe CorocoPhillips' record since 2000 clearly demonstrates our commitment to try to move this project forward. We are doing what we can to do that, but we see that these inducements should be out there for any project and if the state takes the chance of tying up those inducements, which would be normal - Let's just say permitting a project is a normal sovereign power the state would have. If you give - grant those exclusively, we could see ourselves - if you've chosen the wrong winner for some reason - the state's chosen the wrong winner, being delayed for a decade with those inducements being tied up to that licensee.

So that's where our concern stems. I do believe there's value in some of these inducements - particularly those around streamline permitting and those around getting Alaskans ready for the jobs. We would prefer to see those apply to any project that is being advanced. And let the market choose which project goes forward.

3:08:49 PM

MS. KING: The next area that I wanted to talk about is the resource package. And once again I want to draw our attention to what do I mean when I say "the resource." The resource, once again, is getting the owners, the leaseholders, explorers, whoever else that might want to show up for an open season - those that would be asked to make the shipping commitments to the project. And the issues that they face, they're unique in being asked to make that shipping commitment.

As we stated last month in Senate Resources, the resource risks have always posed the greatest obstacle to a gas pipeline. The predominant resource risk that we want to continue to focus on with the state is in obtaining clarity on the state taxes and royalties that are needed in order to secure long-term shipping commitments. Addressing these issues remains a critical component to make this pipeline a reality.

ConocoPhillips appreciates the recognition of the importance of resource issues for a proposed gas line project. Sections 300 - 320 in the bill.

CHAIR HUGGINS: Give us your page number and line.

MS. KING: I'm looking them up right now. Page 14, Chairman Huggins, page 14 is the qualifications for resource inducement. 310 is the royalty inducements.

CHAIR HUGGINS: Line 7

MS. KING: Actually, in moving all the way through pages 14 -16 is the whole package of resource inducements that are in the bill.

Those sections, 300, 310 and 320 - so pages 14-16 - would not be in the bill if the administration had not recognized that changes were needed on the resource side. We also appreciate the administration identified that fiscal stability is a critical resource issue by proposing the ten year stability provision.

A troubling aspect of the resource inducement package is the tie to the exclusivity of the licensed project and the treble damages clause. So I'm going back again now to

section 440 in the bill. Is the state not willing to provide term inducements to any potential project that is being advanced and to any party that underpins the pipeline construction with a firm transportation commitment? What if the chosen winner makes some promises that can't be delivered on? What happens if the licensed project stumbles? Is the state willing to give up their right to change tax terms and royalty terms, which is a contractual arrangement, outside of the licensed project without creating litigation exposure with the licensee? What if the state picks the licensee but we know that the licensee can not deliver on what they say? We will not have the right to get upstream stability and provisions for any other open season on a different project for up to ten years or expose the state once again to damages.

We do not want to see the project tied up in exclusive arrangements or exposed to the larger damages in order to have a backup plan.

More to the specific side of the resource provisions, we remain concerned that the provisions in the bill need more work. The present bill promises to make some changes in the royalty contracts, but rather than negotiate changes to the contract, the bill would require the resource owners to accept being subject to as yet unwritten regulations and the regulations are subject to change every two years.

The bill promises a degree of protection against potential changes to the gas production tax, which is a start. However, it does not identify the protected production tax rate, and the period of relative stability is insufficient for a project of this magnitude. In addition, there is no protection against increases in other taxes that may be aimed at circumventing the protection. To give an example of that: If you had gas production tax stability, state corporate income tax could be increased to offset what you...basically the terms that you had there. So that balance of looking at the entire tax structure is something we think is important. We need to develop a complete resource package, and it's going to require creativity, open dialogue, and consensus. We believe that developing a resource-inducement package is important. In fact, [it is] the most important aspect that will advance a project to a successful open season--but more work is needed.

2:13 PM

The next area that I want to move to is midstream requirements. My first question is: Why would the state be so proscriptive in the midstream requirements? The current version of the bill has a long list of requirements that a party must demonstrate to the administration's satisfaction before their bid would be reviewed by the public and the legislature. Any bid that did not meet all of the bid requirements would be rejected out of hand, even if it brought the best all-around solutions to the challenges facing this project. For example, a bid that met every one of the requirements, but said, "I cannot meet three fixed-date requirements, because we felt that that might not be consistent with the best project management tools and skills that are out there," the bid would be rejected as a non-conforming bid. For approximately a year, ConocoPhillips has indicated that we have alternatives on different work commitments if the right resource framework was in place, but the proscriptive nature of the requirements would not even allow us to bring that creativity to the table; it would be rejected as non-conforming bid. Another example of this is what if a company decided they did not want the state capital contribution prior to the open season? For our project, we have estimated it could cost \$400 to \$500 million to get to the open season. The bid requirements would require us to take \$200 to \$250 million of state contributions to be a qualifying bid. Should we be required to take that money from the state as part of the bid?

2:31 PM

SENATOR WAGONER: You keep saying 'our requirements'. You talking producers as a whole, or you talking just ConocoPhillips?

MS. KING: First and foremost, I am always speaking on behalf of ConocoPhillips; I'm not speaking on behalf of a producer group or big oil. I am here representing ConocoPhillips. Now with respect to the second part of that--the midstream requirements I'm talking here are the ones that are actually laid out in the proposed AGIA bill. I'll probably get the number wrong, but there's a number of requirements that are in there that you need to meet to be considered a conforming bid. And that long list of requirements is the one that I'm speaking to now, Senator Wagoner.

One of the few times that a pipeline really has risk in this project is prior to that open season. I guess there's a question in my mind, if you're not confident enough that you can have a successful open season, and you require an inducement from the state to get through those relatively small costs—we're talking \$500 million out of a project that could be in the magnitude of \$30 billion—you have to question what role you can play in the project. What about the objectives of the customers, the shippers? How do you balance the fact that many of these requirements flow through directly to the shippers? What stops a pipeline company from promising all of these terms, knowing that they can pass them on to the shippers and have the benefits of the exclusive inducements for over a decade? What happens with an empty promise? How does the state deal with someone saying they can deliver a particular size pipeline and then eight years later saying: I can't, I didn't get the firm shipping commitments, they were inadequate, financing wasn't available, or FERC wouldn't approve the project? The current bid process encourages bidders to bid high and then beg forgiveness rather than to bid realistically. We suggest changing the current list of bid requirements to bid variables that would be consistent with the administration's goal of fair and transparent process, but would allow companies like ConocoPhillips, who have a lot of experience in these types of deals, to use our creativity. We understand the state has some must-haves. Isn't it an easier way to say to the industry, we have these demands: Alaska-hire, options for gas for Alaskans, rock-solid work commitments, and others? Please bring us, industry, the most creative solutions you can to meet those demands. The final area that I wanted to move to is the mandating expansions and rolled in rates.

Why would the state want to mandate enhancements for late shippers that could threaten the viability of the basin-opening project and impair state revenues? ConocoPhillips is the state's largest explorer, and I draw your attention to this slide here. And I think we can bring a different perspective to this issue. From this slide you can see that ConocoPhillips has a strong land position. The color in orange is lands that we hold that are ConocoPhillips operated. The ones in yellow are ConocoPhillips non-operated. We drill a number of exploration wells in Alaska every year, and we continue to explore in a region that we know is gas-prone: the NPRA. ConocoPhillips is concerned

that the initial shippers, who will be asked to sign up for billions and billions of dollars in firm shipping commitments that will make the pipeline project feasible, are being asked to take on more risk under the proposed bill than under existing statutes and regulations. Why would a party sign up as an initial shipper if I could wait, secure in the knowledge that an expansion could be mandated and its tariff mitigated through rolled in rate subsidies? At some point you have to ask: Are all these promises for explorers actually driving the behaviors you want?

For over four years, I have heard companies saying they need more time prior to an open season so they can drill. We have been actively trying, since 2001, to advance a gas pipeline project and get the government frameworks in place. These issues—or explorer issues—have been debated with the federal legislation—the Alaska Natural Gas Pipeline Act—and have been debated in front of FERC with orders 2005 and 2005a. And both times a balance was struck, and there's still no drilling. Why should I drill now when the state continues to push to provide guaranteed subsidized rates for those that defer drilling? ConocoPhillips continues to spend millions of dollars every year to advance a gas pipeline. We believe the single largest variable that will motivate new exploration on the slope is a gas pipeline and a successful open season. With costs going up the way they are, we are letting a million dollar issue drive the billion dollar issues. Let's keep our eye on first things first. Let's compare the risks — the next graph here — that [an] initial shipper faces versus a later shipper. And I recognize this is a subjective, qualitative-type analysis, and we might have debates about whether there should be one and a half X's here or two X's here. It's more intended to be just an indication.

I'd flag initial shippers—just going down here through the list—the initial shippers are going to be asked to sign up for shipping commitments, potentially a decade before gas is delivered to the market and with huge levels of uncertainty in the resulting toll they may have to pay. The cost environment for those upstream developments that the resources are facing, and the expenditures that you could be facing, and trying to advance those upstream developments in parallel to the largest pipeline project in

North America. Let me just highlight this issue again. We're going to be trying to get our assets ready on the upstream side--trying to get Prudhoe Bay ready for gas productions; trying to develop other fields, and for us that can involve things with NPRA in parallel to the largest private construction project in the world.

Our upstream developments will be competing with the pipeline project for the very goods and services that we're going to need to have the gas ready, and that is a risk that an initial shipper is going to face in having your gas ready for the day the pipeline's ready. We do acknowledge that gas reserves and deliverability--that's a risk that any shipper faces, whether you're an early shipper or a late shipper. The increased state take over a period of FT is also there for initial shippers versus late shippers, but the initial shippers are going to be asked to sign up for shipping commitments that could last for decades. A late shipper may not have to sign up for that duration of a shipping commitment.

The increased tariffs from rolled in rates on expansions--that's something that the initial shippers will face, and to a degree, a later shipper might face to, and I'm going to give an example of that later on here. The project delays that usually account to more costs; usually projects being delayed, you're spending more money and it translates to more costs. So, yes, that is something a pipeline entity carries a risk while they're in the construction phase, but when the costs are finished, they will be able to pass them through, in its whole, to the initial shippers and to the late shippers. And then the pipeline also has a risk around obtaining those shipping commitments from credit-worthy parties. Once again, will the market support that this is the best project to do? I want to just flag: the risks are very great for the initial shippers, and we think we have to be careful that we don't set up an environment where you're in a place where everybody would say: I'd rather be a late shipper. We have to get the project out of the starting gate. The fact remains [that] the magnitude of these initial shipping commitments are huge, at a toll of \$3.50 for a 20-year shipping commitment, that initial shipping commitment can be in excess of \$26 billion for a 1 bcf/day commitment. Now multiply that number times 4 to get to a 4 bcf/day pipeline; it's about \$100 billion worth of shipping commitments that will sit behind this project when

it has an open season. That value is several times the value of many of the companies that might apply under this process. I ask myself, who has the financial strength to sit behind those types of numbers if natural gas prices plummet for a period of time, or if a field has deliverability problems? I also want to emphasize that I'm surprised that access is being raised as a question. I'm actually not aware that access has been a problem for anyone to date on the North Slope. Anadarko is our partner, and Alpine has access to facilities to produce their oil in NPRA. They have access to TAPS. We know their spare capacity in TAPS, and we have demonstrated a willingness to work facilities access with parties like Pioneer.

With respect to the Alaskan Natural Gas Pipeline, the US Congress already created an unprecedented provision with mandated expansion provisions to ensure access to this pipeline. She emphasized that there's no similar provision on any other pipeline in the Lower 48 than the mandated expansion that was passed in section 105 of the Alaska Natural Gas Pipeline Act. If a shipper is willing to sign up for firm shipping commitments, which translates to pay for the expansion, and can demonstrate that that expansion won't require others to subsidize it, the FERC can order an expansion of the Alaska Natural Gas Pipeline. In addition, there's absolutely no issue with a party making a firm shipping commitment on the gas pipeline project, even if you haven't found gas. You just need to be prepared to pay the toll. Isn't the real issue here not access, but the cost of that access? I understand why the state wants to create enhancements for exploration.

As an explorer I'm happy about that. We want to see new gas volumes, we want co-venturers to explore with Unalaska's North Slope, and I think I've communicated this before, but it's pretty risky drilling exploration wells at one hundred percent dollars; we like to have partners to explore and help spread our risks. We are the state's largest explorer and we can see both sides of the equation on many of these issues regarding expansions and rolled-in rates. ConocoPhillips does not oppose the application of rolled-in rates, for some expansions.

3:27:39 PM

We do have some concerns with mandating that application, that application, for all potential expansions. We are not opposing the language in FERC order 2005 and in 2005 A, that grants the presumption of rolled-in rates. I'm going to read from that order 2005.

11:26:06 PM

In conclusion, to provide guidance to potential shippers in advance of the initial open season that is subject of this rule, the commission intends to harmonize both objectives: rate predictability for the initial shippers, and reductions of barriers to future exploration and production in designing rates for future expansions of any Alaska natural gas transportation project. It is consistent with our guiding principle that competition favors all of the commission's customers as well as with the objectives of the act to adopt rolled-in treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers if any subsidy were to be found.

That's on page 44 and 18 CFR part 157 order number 2005, which was February 9, 2005. Let me illustrate a few concerns with the approach we have with mandating rolled-in rates for all expansions and mandating expansions that may be commercially unreasonable. Some of the exploration volumes could be from federal or private lands and some may even be from lands that the state can't tax. I'm drawing your attention to this graph here that was in your pack. This is here just to kind of illustrate - we tend to focus a lot of our attention right here, on this little circle in blue here, where the existing infrastructure is. But in reality, these exploration volumes we're talking about are likely going to be in the Chukchi [Sea], the Beaufort [Sea], NPRA, ANWR [Arctic National Wildlife Reserve], and the foothills, so we tend to focus in on a small area and the exploration volumes are going to be out in these different regions.

If you skip then to the next slide that I've got in the pack, these are from public ally available sources from different - the United States Geological Survey assessments, and I've put the dates down as to when the different assessments were made, but I'd like to draw your attention to the three biggest numbers on here: the 83, the

potential, the largest potential areas; 83 tcf in NPRA, 72 tcf in the Beaufort, 210 tcf in the Chukchi - and I've worked on these, these are technically I think recoverable-type numbers. But those three biggest numbers are in areas where the state has no royalty, or no, or some of these, not even production tax. Let me explain an example of where I think, from the state's perspective, you might question whether or not mandating rolled-in rates would work.

Prudhoe Bay has a toll, for example, of four bucks. There's an expansion that comes along that says the toll would go up to four-sixty, a fifteen percent increase. The state would receive less royalty in production taxes, less permanent fund contributions from Prudhoe Bay by the fact that the toll was going up. Now many people have argued saying, there could be state-wide inducements or benefits from that other [indisc.] exploration coming in here. But what if that exploration volume is from a field in the Beaufort where the state has no royalty or no production taxes from it. So you would be in a place where you're receiving less royalty and less production taxes from Prudhoe Bay, but no new revenue coming in from that field, coming from the Beaufort. And I do acknowledge there's gonna be some socio-economic benefits of having developments going on in the Beaufort, but you will not be getting a revenue stream directly from those developments. Another example of mandated rolled-in rates which could be problematic is an NPRA example.

What if we are successful in NPRA after initial open season and we think we've got a good expansion; 800 million a day, cubic feet a day, kind of expansion? And I'm actually just grabbing numbers for illustrative purposes, I'm not actually calculating. The toll, once again, let's just say the toll was four bucks. If that toll, due to this 800 million-a-day expansion, through the application of rolled-in rates, was a good expansion, you might see the toll go down for everybody to \$3.80. That explorer that was making the development decision to produce or develop that field said the toll is \$3.80. It looks like I should go ahead with this development. Five years later, there's another expansion where the toll would go up to five bucks because it's an expansion from the Beaufort. You made your investment decision thinking that you had a \$3.80 toll, and all of a sudden now you're facing a five dollar toll. That's the type of uncertainty that even as an explorer or

a late-shipper, you might be exposed to by mandating rolled-in rates.

Another example would be, for example, if there is some short-haul service to Fairbanks, and short-haul means that you just said I want to take capacity out on open season just to ship my gas from the North Slope to Fairbanks, and let's just assume that that toll was fifty cents. If there was an expansion, they could be exposed to the toll going up from fifty cents to fifty-seven point five cents and all of a sudden, consumers in Fairbanks are saying, why am I having to pay more to transport the gas when there's an expansion coming in from somewhere else that's not delivering any more volumes here? So there's both, on the customer end, as well as on the shipper end, scenarios where mandating rolled-in rates may not be in the best interest of all the parties involved. All we are suggesting is let the FERC be the adjudicator on this issue.

ConocoPhillips might very well be the company in there arguing for the application of rolled in rates, and the state might want to be on the opposite side, or vice versa. Our perspective is, we just don't know what the expansions might look like, what they might come from.

FERC has rebuttable presumption of rolled-in rates that's not being challenged. What we'd say is just let the FERC adjudicate those issues and all of us have the flexibility then to argue our case for whether we think the subsidy's been made at that point in time in the future. I'd also highlight that there are many tools in the state's toolbox to deal with the issue of enhancing exploration and motivating expansions, including things like royalty reductions and tax credits. The state could put a capital contribution in on an expansion at some point in the future; there's many tools in the state's toolbox to incent that exploration. What is inappropriate, though, is to require the initial shippers, the ones who have already taken exploration risks to find the existing known resource, you'll be taking on the multi-billion dollar risk that will make this pipeline possible, to subsidize those that have not yet taken those risks. We can't let unknown gas prospects that could take a decade to explore, appraise, and develop, drive the timing and development of the approximately 35 tcf of known resources, and the largest private construction project in North America. I'll

conclude my remarks today by summarizing what I think are the key issues.

ConocoPhillips is ready to solve issues with the Alaska Legislature and the governor. We want to actively work with you to achieve a framework that promotes the development of the ANS gas resources and addresses the legitimate interests of all parties.

The key to advancing the gas pipeline is really to address the resource issues and providing adequate security to companies so that they can make the long-term shipping commitments, is the critical issue that will result in a project. We urge you to not lose sight of this fundamental issue. The project is so difficult that we have to be on the same team and we have to recognize that compromise, like in all major decisions in life, is necessary for all parties. We have to have focus on doing what it takes to get this project moving forward. We can't lose sight - the costs are going up on the project. The recent announcement on the MacKenzie Delta project - the costs increasing confirms this, and should make us all step back and pause for a second.

We need to remember the real prize: the tens of billions of dollars in new tax and royalty revenues, the countless jobs, the new economy that will be created with a new gas exploration and development industry for decades to come. To achieve this prize the risk must be realistically addressed and risk and rewards must be balanced. We've had thirty years of an oil economy; we need to look forward to a new gas economy. We need to find a creative way to make it happen. No company will work harder than ConocoPhillips to make this project a reality. I'd be happy to try to answer any of your questions.

[End of Ms. King's verbatim transcript]

SENATOR WAGONER asked for a copy of Ms. King's testimony.

ALASKA STATE LEGISLATURE

Sen. Charlie Huggins, Chair
Sen. Bert Stedman, Vice Chair
Sen. Lyda Green
Sen. Gary Stevens
Sen. Lesil McGuire
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Sen. Thomas Wagoner



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Senate Resources Committee

Butrovich Room 205

Monday, March 26, 2007

AGENDA

- **SB 104 – Natural Gas Pipeline Project**
"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

3:30 – 7:30

TransCanada –

Tony Palmer, Vice President Alaska Development

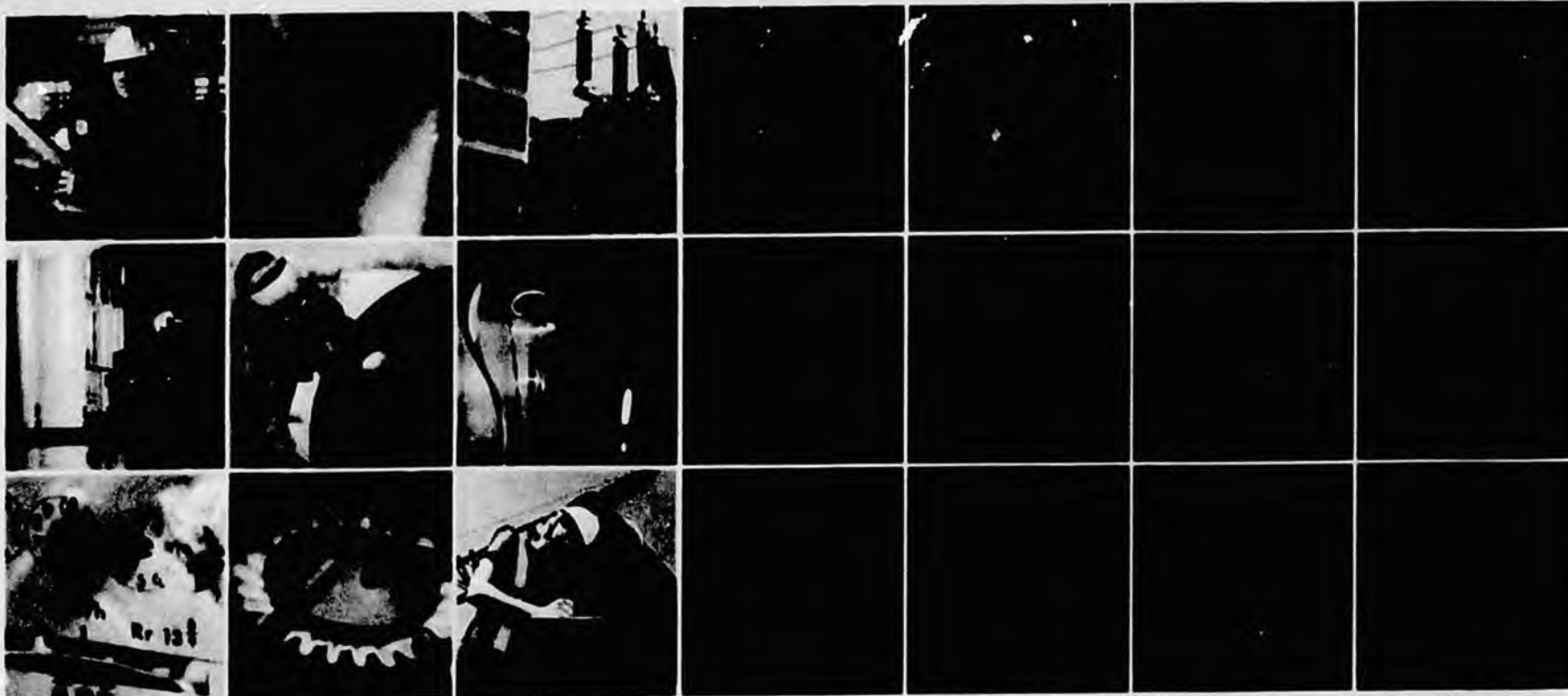
Alaska Gasline Port Authority

Bill Walker, General Counsel and Project Manager

Paul Fuhs, Government Affairs

ONLINE

Radoslav Shipkoff, Financial Advisor



Alaska Legislature Testimony Alaska Highway Gas Pipeline Project

Juneau, Alaska
March 26/27, 2007



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