Gasline Update: Interim Report or Post Mortem?

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Why a gasline? i

- 35 Trillion Cubic Feet in known North slope reserves.
- Potential Resource Base
  - Undiscovered Technically Recoverable Conventional Resource 160 tcf
  - Undiscovered Technically Recoverable Conventional Resource 18 tcf
- Subtotal 212 trillion cubic feet

Source – DNR Division of oil and gas

Why a gasline? ii

- Gas Hydrates in Place Resource (USGS 1995)

    33,000 tcf

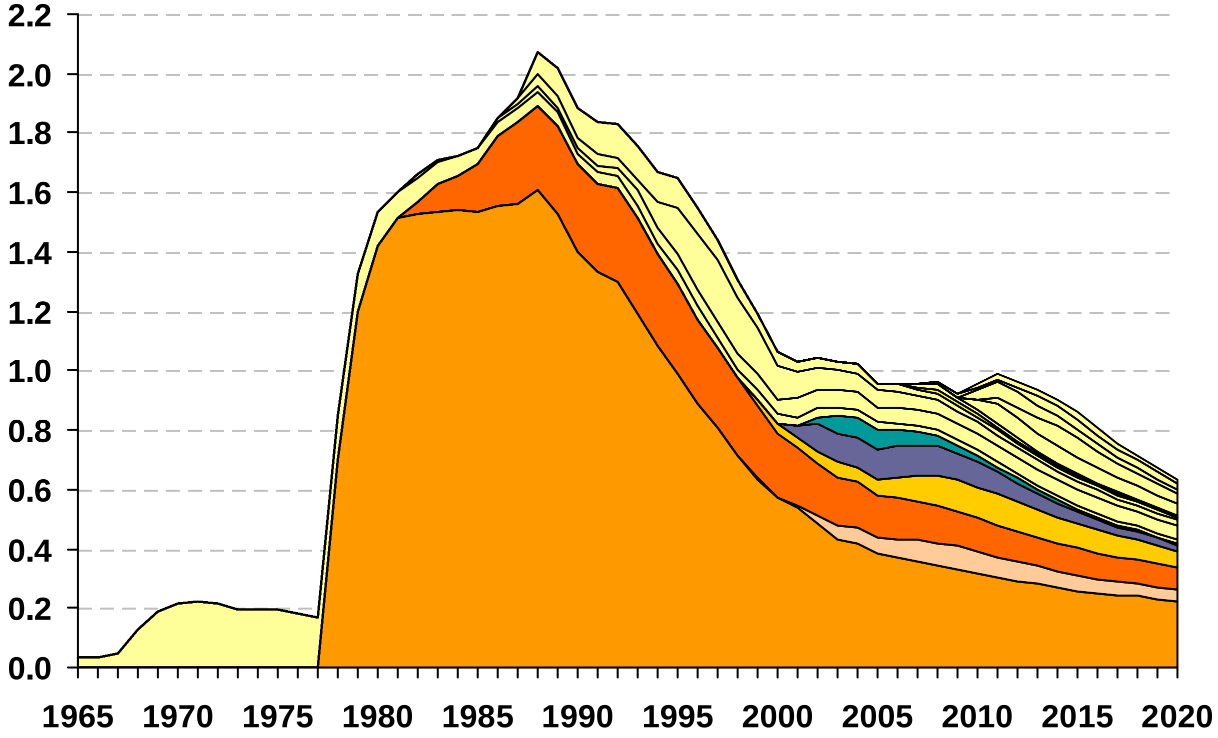
Coalbed Methane in Place Resource (AAPG-SPEM conference 2002)

  800 tcf

- Basin Total: 34,000 tcf

Source – DNR Division of oil and gas

Alaska Oil Production



What does it take to get a gasline?

- Answers from
  - The State of Alaska
  - The Lessees which have the right to produce 35 trillion cubic feet of known North Slope Gas
  - The Federal Government
  - “Other Projects”
- Common Theme

What Does it Take to get a Gasline? – Common Theme

- It takes an FT commitment
  - No matter who builds the pipeline, it will be financed by the shippers commitments.
  - Gas owner's FT will underwrite the project

What Does it Take to get a Gasline?

- It takes an FT commitment
  - Federally Mandated Open Season
  - Commitment to ship if pipeline is built
  - Pipeline gets guaranteed rate of return, but has to build a pipeline to carry gas for anyone willing to make the FT commitment
  - Necessary for Permitting, Financing

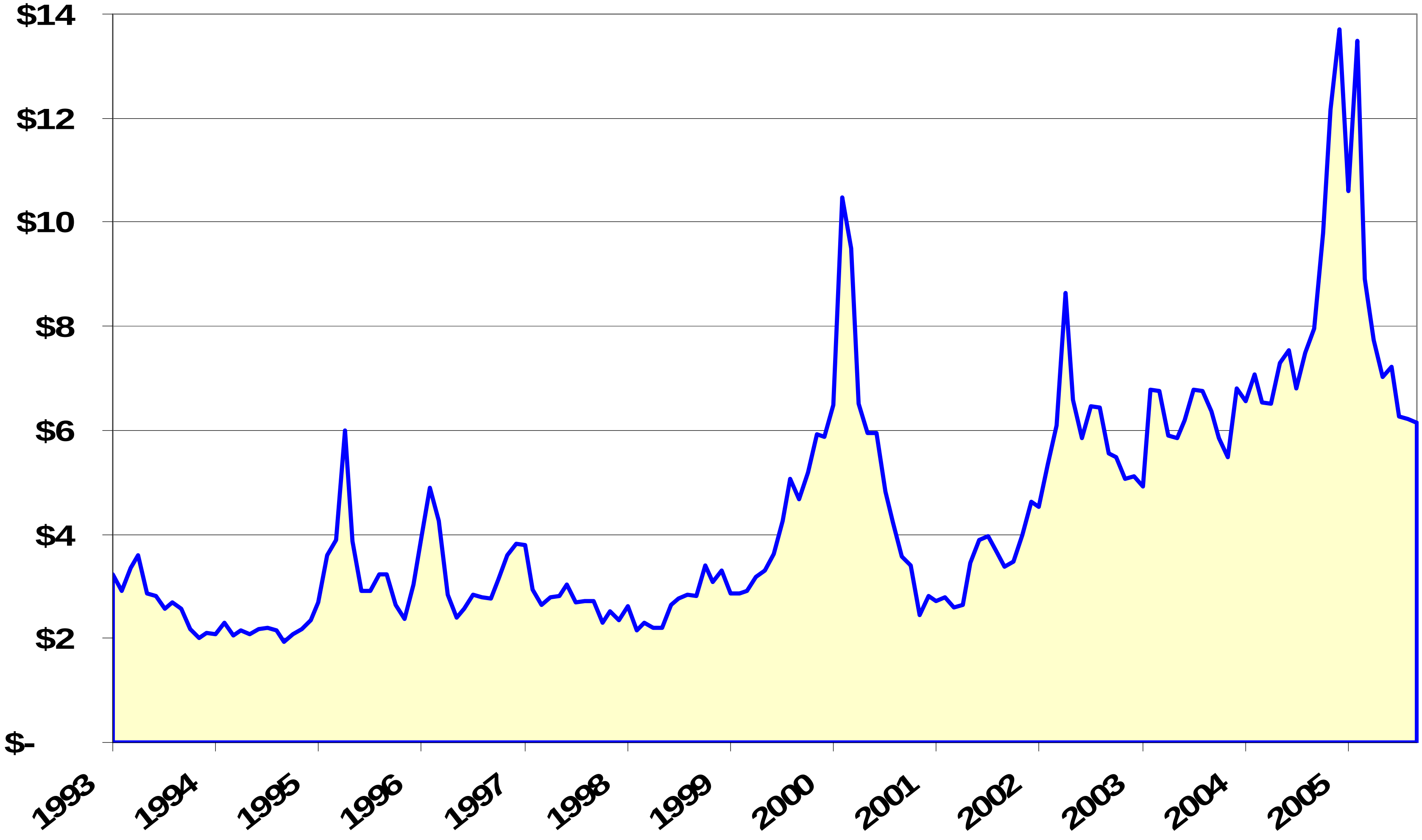
1. What do the lease holders do to get a gas pipeline?

- Lease Holders' 4 Legged Stool for Risk Reduction
  - US Federal – Pipeline act passed in November of 2004.
  - Alaska – Stranded Gas Contract
  - Canadian Issues – Trans Canada, NPA and treaty rights.
  - Cost control.

1.1 Cost Control

- In 2001 still viewed as uneconomic project by lease holders.
- Profitability for resources owner is combination of tariff cost and commodity value
- Note: Actual Pipeline owner and operator gets (i) FT commitments from shippers and (ii) cost based tariff including regulated rate of return based on prudently incurred cost base.

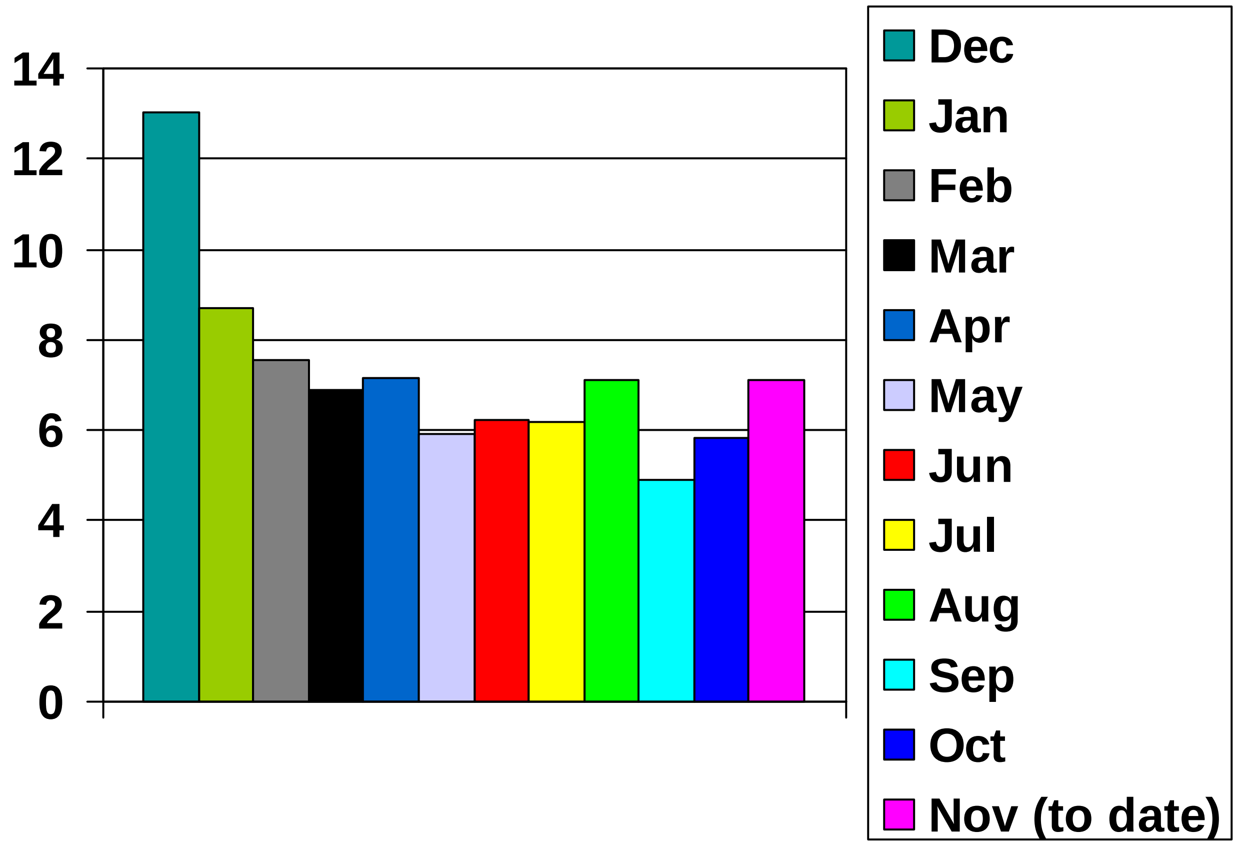
Natural Gas Prices



Historical monthly Henry Hub natural gas prices ($/ million BTU)

Natural Gas Prices Henry Hub December 2005- November 2006

Sept 29 2006 - $3.66



1.2 Canada

- National Energy Board
  - Projects require “Certificate of Public Convenience and Necessity”
- Northern Pipeline Act (Agency)
  - For the project subject to 1978 treaty
  - Granted Certificate to Trans Canada Subsidiary

1.3 What do the Lease Holders want from the State?

- Use the Stranded Gas Development Act to support a commercially viable project by providing State take terms that are
- predictable,
- durable and
- enhanced.

“predictable”

- Cook book set of PILT rules found in the proposed Alaska Stranded Gas Fiscal Contract
- Covered all Taxpayers’ major tax obligations from “Schedule D” – North Slope Leases, including
  - Oil production taxes
  - Oil and gas production, exploration and pipeline property Ad Valorem taxes
  - Income taxes from Oil and Gas business
  - A reserves tax
  - Other sales and use taxes that could effect construction and operation of pipeline.
  - Royalties remain under royalty contracts

“durable”

- Proposed contract would have started immediately and was for 35 years after Commencement of Commercial Operations (CoCO)
- Oil related taxes had renewal/opt out options built in for last ten years.
- Disputes are arbitrated – similar to royalties today.
- Work will proceed through 15 months of initial court challenge.

“enhanced” - gas

- Much of the negotiation
- By taking 20% of the gas, the lessees IRR for the project is boosted by the same amount that eliminating all state take would have.
- Already good NPV and profitability index project.
- Ended up with “status quo” take for gas

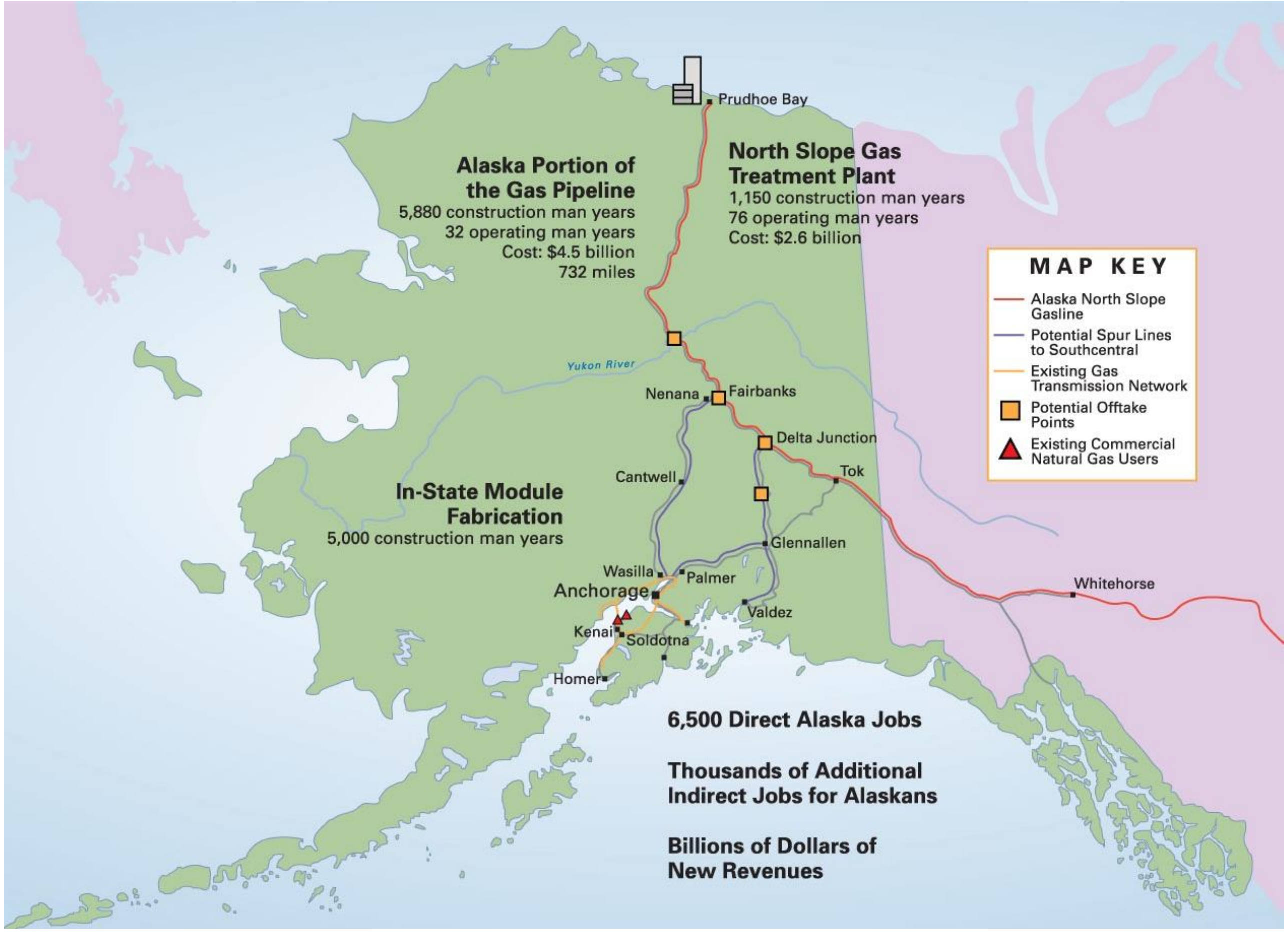
“enhanced” - oil

- PPT law - switched the production tax from regressive to progressive and significantly increased state take at higher prices.
  - Old tax was 7.5% on **gross** (15%, .5 average ELF)
  - New tax is 22.5% on **net**
  - Legislature added specific surcharge tied to wellhead value
- Contract will require renegotiation of oil terms

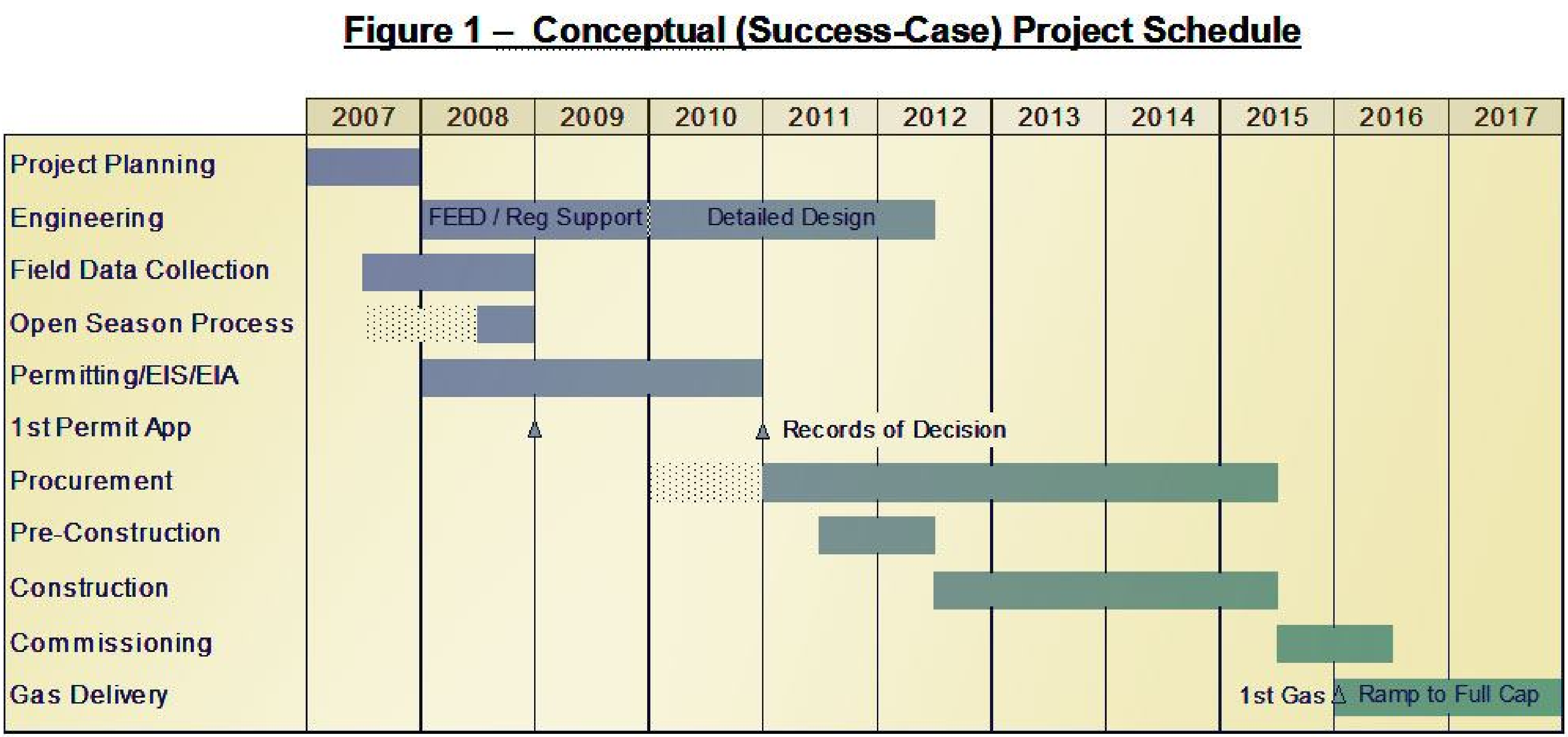
“enhanced” - gas ii

- Old “status quo” was roughly 7.25% take on gross for gas.
  - Different ELF formula
  - 10% tax rate vs. 15% tax rate
  - Envisioned all costs deductible under PPT
- New “status quo” is roughly 22.5% of <u>net</u>

Map of the Proposed Project



Timeline and Process… Accountability



1.4 Federal Gates- ANGPA

- Open Season
- EIS
- FERC's certificate of public convenience and necessity
  - Under ANGPA FERC is the lead NEPA agency for the EIS
  - Streamlined "pre-filing" process

2. What does the Federal Government do to get a Gas line? i

- Alaska Natural Gas Pipeline Act of 2004:
  - Expedited 20 month FERC process from submission of application to certificate of public convenience and necessity
    - 1 year for preliminary EIS –(sec. 104)
    - 180 days for final EIS (unless more time required) (sec. 104)
    - 60 days for granting (or denying) certificate (sec. 103)

2. What does the Federal Government do to get a Gas line? ii

- Alaska Natural Gas Pipeline Act of 2004:
  – Expedited Judicial Review (sec. 107)
    - 60 days to file
    - US Court of Appeals for CD
    - Expedited Consideration

2. What does the Federal Government do to get a Gas line? iii

- Alaska Natural Gas Pipeline Act of 2004:
  - No over the top route (regardless of cost) (sec. 103)
  - FERC must adopt Special Open Season Regulations (sec. 103)
    – Gives FERC authority to mandate expansion (sec. 105)
    – Federal Coordinator & if no application by April 2006 – federal study including federal takeover (sec. 106 & 109)

2. What does the Federal Government do to get a Gas line? iv

- Alaska Natural Gas Pipeline Act of 2004:
  - Loan guarantees for 80% of project cost or 18 billion (sec 116)
    - For a term not to exceed 30 years
    - Include Canadian portion of project
    - Administered by Department of Energy

2. What does the Federal Government do to get a Gas line? v

- American Jobs Creation Act of 2004:
  - 7 years accelerated depreciation for US portion of project (excluding GTP)
  - 15 percent EOR federal tax credit extended to a GTP

What did the state want from a gasline?

Gov Murkowski’s six principles:

- 1. Alaskans deserve a fair share of revenue from a gas pipeline project
- 2. Alaskans need the opportunity to access the gas
- 3. Future explorers must have access to the gas pipeline
- 4. The gas pipeline must be expandable
- 5. The state should share in the wealth by owning a portion of the gas pipeline
- 6. Alaskans deserve Alaskan gas pipeline jobs

3. What did we do to try to get a gasline?

- Stranded Gas Development Act
- Accepted applications from qualified sponsors through
  - Qualified Sponsors included Producers (Exxon Mobil, Conoco Phillips, BP) Trans Canada, Enbridge
  - Not qualified: Alaska Port Authority
  - Withdrawn – Mid America Energy Holdings

3. What did we do to try to get a gasline?

- Made it more likely that there will be an open season and that FT commitments will be made.
- Opted to work with producers that have
  - leased the gas resources
  - built comparable projects
  - Will be financing pipeline who ever builds it
- Came up with contract that offered
  - “durability”,
  - “predictability” to the degree we had good crystal ball and drafting skills, and
  - “Enhanced” through state participation

Gist of the Deal i

- State would take roughly 20% share of gas in kind, own 20% of the pipeline, but most importantly, be responsible for 20% of the FT commitment

- This has the same effect on challenged IRR as giving up all state rents.

Gist of the Deal - ii

- Durable and Predictable Fiscal stability
  - On the Midstream
  - On the Upstream
  - On Producer's other streams (i.e. Oil)
  - Method of fiscal stability:
    - detailed cook book contract and
    - arbitration instead of courts.

Gist of Deal iii

Producer will proceed diligently toward sanction.

- No schedule driven benchmarks.
- No obstacles assumed away.

If Project is sanctioned and built, Sponsors will make required Payment in lieu of tax.

Alternatives

There are lots of alternative contracts that could preserve the gist of the deal while reworking other aspects

- For example “know the rules” vs.. “know the effect of the rules”
- Find a different ‘state take’ balance

4. What would “other players” do to get a gas line?

- Could do the work to hold an open season.
  - Offer negotiated rates that share risks of cost overruns
    - Builder entitled to cost based rate for costs
  - Could hope for – or create – situation where non commercial player decides to participate in open season.

4. What would “other players” do to get a gas line.

- Independent pipeline company:
  - Most likely request would be for state “assistance” in bringing producers to the open season.
    - Support for bad public policy choices like a reserves tax.
    - Wresting the leases back from the lessees for lack of development

4. What is relationship between State and resource owner if “other player”?

What concessions would producers ask for from the state before signing an FT commitment? Upstream fiscal stability? Gas? Oil?

If gas is transferred at below market rates to a third party would state be willingly to accept that value for tax or royalty reporting?

4. What would “other players” do to get a gas line?

- Does Trans Canada bring certain Canadian rights or advantages to the table?
- How should state intervene in commercial relationship between Trans-Canada and leaseholders?
  - To enable a gasline
  - Advantage one commercial party or the other
  - Because we have an upstream interest, we are more like a shipper than a carrier

Summary – not so FAQs

- Q: What does it take to get a gas line?
- A: FT Commitments
- Q: What do the lessees want prior to making FT Commitments?
- A: Reduced risk through SGDA contract
- Q: Ought Government to shift risk by
  – Taking 20% of the gas
  – Granting fiscal stability? (including PPT)

Summary – not so FAQs

- Q: Are there other ways of enabling FT commitments?
  - change the resource owners to shipper that does believe it is better able to control costs.
  - Revisit existing applications and have the state absorb the risks that neither shippers or carriers are willing to take (cost overrun?)
  - “solicit new projects” and hope they will come up with new and better solution
  - Change the form of risk sharing in the negotiated contract.

Websites

- Gov's Office:
  - http://www.gov.state.ak.us/gasline/
- DOR
  - http://www.revenue.state.ak.us/GasLine/index.asp