

**Lee Gorsuch Public Policy Forum – The Alaska Natural Gas Pipeline
Outline of Comments by Ken Konrad, BP Senior VP, Alaska Gas
November 29, 2005**

I'd like to thank ISER for the invitation to be here tonight.

When I spoke to Fran Ulmer about joining this panel, I initially wondered: "Is the timing right?" We are still working to finalize the fiscal contract negotiation, and therefore don't yet have details available for public presentation.

But Fran assured me that ISER wanted to focus on matters of policy . . .

And I thought, "What a wonderfully refreshing idea – Policy not Politics," and I gladly accepted the invitation to speak.

So here I am

This is an exciting time for our business in Alaska and Alaska itself. The prospects for North Slope gas commercialization have never been better. And in the hope and expectation that we will gain legislative approval for a fiscal contract next year, BP is in the process of creating business plans for a 50 year future in Alaska.

A gas pipeline can catalyze that type of future on the North Slope by capturing the synergies of producing and selling both oil and gas. And we believe that with a successful gas pipeline project, we can extend the economic life of the North Slope for decades to come.

To set a foundation for this evening I'd like to focus on a few items and of course I look forward to answering questions from the panelists and the audience. My areas of focus will include:

- Direct State Participation in the project
- Which project is best for Alaska
- Why fiscal stability is important

Let me start with direct State participation in the project.

Most people seem to support the Governors six principles regarding gas commercialization. However, on one of the principles there is sometimes hesitancy, and occasionally disagreement. That principle is about the State having direct participation in the project itself.

Many people mistakenly think "direct participation" only refers to the state owning a portion of the pipeline. But it is worth noting that direct participation by the State means more than that, and includes four inter-related elements:

- Taking gas-in-kind;
- Obtaining transportation capacity on the pipeline;
- marketing the gas; and

- Taking a proportional ownership position in the pipeline itself.

These four items, although separate and distinct, are inter-related I'll touch briefly on each.

Taking oil and/or gas in kind is how our industry operates everyday. The operator of an oil or gas field does not typically sell products on behalf of the field owners. Instead, each owner in a property takes its share of production 'in-kind'.

While it is normal business for us, we recognize governments often take royalty "in value." However, under a program that began a number of years back, the U.S. government, through the Minerals Management Service (MMS), began a program of taking federal royalty gas in kind.

This program has a number of objectives including:

- Realizing higher net revenues for the U.S. taxpayer
- Reducing administrative costs within the MMS
- Reducing disputes with industry

All indications are that the MMS program is working and they plan to extend and expand the program.

U.S. taxpayers should be pleased to be getting higher value for their gas. But in the context of the fiscal contract, the producers are particularly attracted to the idea of dispute reduction. For those interested in learning more, the MMS has a very good website that outlines their RIK program and its successes.

Under the direct State participation scenario the governor has outlined, the state would take its royalty gas and a portion of its taxes as "gas-in-kind".

In large part these are severance taxes that have economic attributes very similar to royalty, generally calculated on the basis of:

- Market-price less transportation costs for getting the gas to market.
- On a percentage of production

Today, the state takes a portion of its oil royalty in kind and sells it to in-state refiners.

The state has not pursued the sale of oil outside Alaska due in large part to the challenges of shipping oil on tankers out of Alaska.

The oil-in-kind program has benefited Alaska by providing jobs, investments in local communities, and a stable supply source.

As part of its direct participation in the gas line project, the State would also secure firm transportation to ship the gas to in-state or long-haul markets. The producers would work closely with the State so the state could obtain this capacity in a manner consistent with producer production plans. In addition, the State would likely enter into agreements with one or more of the many gas aggregators to market its gas.

Since the State will be a direct participant, taking its gas in kind and obtaining transportation capacity, it deserves an opportunity to secure a proportional pipeline ownership position broadly related to its resource ownership.

Some have asked the question if State ownership is the right thing for government to do. It is worth pointing out that as a proportional owner, the State would be partnering with world class companies who understand the business.

Just like the producers, the State as a resource owner would realize the benefits of stable cash flow from the pipeline itself, along with other risk reduction attributes. Pipeline ownership is actually the lowest risk aspect of the project.

It is also worth noting that there will not be an obligation by the State, or any participant, to own the asset forever. The State will have the same rights that other pipeline investors have to sell its share of the pipeline at some point in the future depending on its specific needs and desires.

Which Project is best for Alaska?

The short answer is, “One than can actually be built!” – but that answer is probably too short.

The Governor has said that the best project for Alaska is the one that:

- moves the most gas
- at the lowest cost
- creating the highest revenues

Two other points should be noted.

First, the transportation system will be federally regulated. The FERC, or in the case of Canada, the National Energy Board (NEB), will regulate and approve any project brought forward. Although the FERC may consult with the State as it regulates the project, FERC itself has sole regulatory jurisdiction over interstate gas pipelines.

Second, regardless of who owns a gas pipeline, it will be paid for by the resource owners (the producers and the state).

- If owned directly, the resource owners would pay for construction and earn dividends from tariffs
- If not owned directly, the state and the producers would promise to pay whether they use the pipeline or not

As resource owners, the producers and the state have every motivation to make the cost of transporting gas as low as possible.

As to a fiscal contract itself, royalties, taxes and payments in lieu of taxes should far exceed the actual cost of the project – so it’s easy to see why predictability regarding these payments is so important. And virtually all of these royalty and tax payments are made by the producers.

To the extent some portion of future taxes are paid by the pipeline itself, these taxes are simply passed through directly to the pipeline's customers (i.e. the resource owners) in the toll.

Since the producers will either directly or indirectly pay virtually all royalties and taxes, it is not unreasonable to assume a fiscal contract should be entered into with the parties making the payments.

Pure pipeline companies that are not at risk from taxation don't really need to negotiate payments that will be made by others – the producers. So, it only makes sense that a fiscal contract needs to be with the producers, the entities paying the taxes.

A clear and durable fiscal contract is an essential part of what is needed for any project to advance.

Stability / Constitution

It is probably worth saying a few words on fiscal stability and why it is so important for this project to be able to attract capital.

In any industry, global capital flows to areas where investors have confidence they can earn a return. Our industry in particular operates on extremely long time cycles and massive up front costs. Stability over a long period of time is essential.

That is why it is common around the world to enter contracts with governments for very large oil and gas projects – it's all about knowing the rules before massive investments are made, not after.

This occurs all over the world, in places like Azerbaijan; West Africa, North Africa, Sakhalin, etc. The list goes on.

And the Alaska project is the largest single energy project anywhere. Its planning through construction period alone will span ten years and operations for decades thereafter.

BP is now contemplating a 50 year oil and gas business in Alaska; including a successful gas project, and we're making plans to invest amounts approaching \$15bn in our oil and gas business over the next decade alone. These are investments in producing wells, aging oil and gas production facilities, new field development, viscous development, low salinity enhanced oil recovery, etc.

These are investments that can help keep oil and gas flowing for 50 years.

And of course, about half of that investment over the next decade will be for the gas project itself.

These are truly massive investments.

The committee commentary that accompanied the drafting of Article IX of the Alaska Constitution is perhaps insightful. It said in part:

“The power to tax is never to be surrendered, but under terms that may be established by the Legislature, it may be suspended or temporarily contracted away. This could include industrial incentives, for example”.

The framers of our constitution had the vision to realize that large scale industrial projects could be Alaska’s future. They viewed such opportunities as deserving special consideration ...opportunities that could be transformational for Alaska. Most would agree that the building of the fertilizer plant on the Kenai, using the benefits of industrial incentives, helped create high paying jobs and an important tax base for the Kenai. The Alaska gas project can create those types of benefits for all of Alaska.

We are on the edge of a unique opportunity for Alaska – and for the country.

We hope and expect we will be able to conclude our negotiations with the State in the near future. And we look forward to the opportunity to share and discuss the important policy decisions that will be needed to make this project a success.

Thank you for this opportunity. I would be pleased to answer questions.