Appendix A: Comments on the Preliminary Finding

By the November 30, 2001 deadline for comments listed in the Preliminary Finding, the State had received letters from Ken Thompson, Anadarko Petroleum Corporation, Phillips Alaska, Inc. and BP Exploration (Alaska) Inc. AEC Marketing (USA), Inc. sent a letter and written testimony to the Royalty Board on November 9, 2001. AEC Marketing also sent a letter commenting on the Preliminary Finding received by the department after the November 30, 2001 deadline. Williams Energy Marketing and Trading sent comments on the Preliminary Finding in a letter dated December 6, 2001.

A public hearing was held November 13, 2001 before the Alaska Royalty Oil and Gas Development Advisory Board.

- Anadarko testified in favor of the sale.
- AEC Marketing also in favor of the sale and timing.

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AEC MARKETING

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November 9, 2001

Alaska Oil and Gas Royalty Development Advisory Board
c/o Alaska Division of Oil and Gas
550 W. 7th Ave., Suite 800
Anchorage, AK 99501

Attention: Mr. Kevin Banks
Petroleum Market Analyst

This letter is in support of the Preliminary Finding and Determination to Sell Alaska North Slope Royalty Gas in a Competitive Sale ("Preliminary Finding") issued on October 29, 2001. AEC strongly advocates the sale of royalty-in-kind gas and the timeline and process set forth within the Preliminary Finding.

We are confident the proposed royalty gas sale is in the State's best interest and that now is opportune time for the State to capture the maximum benefit from their royalty gas. We also believe initiating the royalty-in-kind process and finalizing the awarded gas sales contracts as soon as possible is critical for current and future gas exploration within Alaska.

Attached is AEC's testimony in support of the Preliminary Finding. If you have any questions, please contact Alan Sharp at (403) 261-2560.

Sincerely,

Alan Sharp

Alan Sharp
Director, Northern Business Development

Alaska Royalty Oil and Gas Development Advisory Board

Alaska North Slope Royalty Gas in a Competitive Sale
Atwood Building, Room 240 at 9:00am
November 13, 2001

Hearing: To discuss the merits and solicit public testimony on the proposed sale and the Preliminary Finding and Determination to Sell Alaska North Slope Royalty Gas in a Competitive Sale ("Preliminary Finding").

Witness: Mr. Alan Sharp, Advisor to AEC Marketing (USA) Inc.

Testimony: Good morning Mr. Chairman and members of the committee. My name is Alan Sharp. I am the Director of Northern Business Development for AEC Marketing and advisor to AEC Marketing (USA) Inc. ("AMUS"). AMUS is an indirect, wholly-owned subsidiary of Alberta Energy Company Ltd. ("AEC"). One of my key responsibilities is to advise AMUS on Alaska natural gas pipeline issues. Such issues include commercialization of Alaska natural gas, which entails access to a pipeline under fair and acceptable terms and conditions.

I would like to start by giving you a brief background on AEC. We are Canada's largest natural gas producer and one of North America's largest independent oil and gas producers. In 2001, our daily production is expected to exceed 370,000 barrels of oil equivalent. Our current daily sales gas production is approximately 1.5 Bcf/d (November 2001 estimate).

AEC is focused on *Growth, Value and Performance* as it builds a Super-Independent oil and gas company. This strategy capitalizes on the world-class assets and high-quality, long-life reserves that AEC has established in its three strong growth platforms - Western Canada, the U.S. Rockies and Ecuador. In 2000, the Company set a target to double production from existing assets within five years.

The Company is also looking to establish additional growth platforms through new venture exploration in Alaska, the Mackenzie Delta, the Gulf of Mexico, Australia, West Africa and Azerbaijan.

Midstream natural gas storage and pipelines assets comprise approximately 20 percent of the Company's asset base and provide a growing source of cash flow. Currently, AEC's enterprise value is approximately US$9 billion.

In Alaska, AEC's U.S. subsidiary has over 1.1 million net acres in the Central Arctic region of the North Slope (i.e., Foothills of the Brooks Range). We have vast experience in the exploration, development, production and marketing of natural gas and have come to Alaska to explore for new non-associated gas reserves.

1. **The first question I would like to address is why we need to establish a royalty gas sales arrangement now.**
   - The Alaska Gas Producer Pipeline Team ("AGPPT") has informed us that an open season for nominating capacity on an Alaska gas pipeline could occur as early as the first quarter of 2002.
   - AEC's U.S. subsidiary and Anadarko are actively exploring in the Foothills of the Brooks Range, however, we will not have proven gas reserves by 2002. Therefore, nominating for firm capacity in the open season is extremely risky from a financial exposure standpoint.
   - As you are aware, there are over 30 Tcf of proven gas reserves on the North Slope. Assuming a 4 Bcf/d capacity pipeline, this pipeline would be full for over 20 years. (Note that in the Oct.2, 2001 testimony to the US Senate Committee on Energy and Natural Resources, Phillips AK Inc. indicated the pipeline would be full for over 30 years). We have a concern that if we do not obtain firm service in the first open season, we may never be able to acquire capacity on the pipeline. Without some assurance concerning pipeline capacity, continued investment in new Alaska gas exploration is unlikely.

- To reduce the risks of capacity nomination and to ensure continued exploration expenditures, Anadarko and AMUS are interested in purchasing state royalty gas to backstop, if needed, any potential nominations for capacity during an open season. We understand that a royalty sales process takes some time and requires legislative approval. We also understand legislative approval is only available from January to May of any given year, restricting the timeframe that a royalty-in-kind sale could be approved.
- We strongly support the State's Preliminary Finding and the timeline for royalty-in-kind gas sales within. Initiating the royalty-in-kind process and finalizing the awarded sales contracts as soon as possible is critical for current and future gas exploration within Alaska.

2. **The second question is what benefits do we and the royalty gas sale offer the State.**
   - We believe that a sale of royalty gas is beneficial to both the state and to companies like ours who are interested in exploring in Alaska for new gas resources. This exploration is a benefit to the State of Alaska and is in addition to the cash bonuses and price premiums as described in the Preliminary Report.
   - Our focus is on non-associated gas in the Foothills. If successful, the State will have new incremental proven and developed gas reserves, plus a more stable and higher State royalty revenue (By this, I mean lowering the State's dependence on oil revenue and its associated gas). Non-associated gas also allows the State to consider enhanced oil recovery projects while still maintaining a stable revenue stream.
   - As mentioned earlier, the existing proven reserves in Alaska would likely fill a 4 Bcf/d pipeline for 20-30 years. If additional pipeline capacity were not added, this would likely mean no gas exploration in Alaska for 20 years, as new entrants would not be able to obtain access to the pipeline. As for the AGPPT, they would not need to explore for new incremental gas reserves for about 20 years. By providing royalty gas to explorers like us, the State can ensure exploration will continue to take place in areas that would otherwise remain unexplored.
   - We believe the State should <u>leverage</u> its gas <u>volumes of tomorrow</u> to <u>support</u> gas exploration <u>projects of today</u>. The State has no risk, as this is a natural hedge. If the pipeline does not proceed, the State would have no obligation to deliver contracted future royalty gas volumes under those circumstances. The benefits are greater exploration and greater revenues, which is one reason why the Preliminary Finding is recommending the royalty gas sale.
   - The more players (producers and explorers) on the North Slope, the more competition that will be created. More competition leads to lower costs and higher royalty revenues for the State.
   - The royalty gas sale would help counter the dominant market position held by the AGPPT. AGPPT owns practically all of Alaska's proven gas reserves. Thus, they have the power to influence :
     a. future exploration and development of new gas resources in Alaska, and
     b. the rates, terms and conditions of pipeline service, whether as owners of the proposed Alaska gas pipeline or as anchor-shippers.
   - More players likely means more jobs for Alaskans. The money we spend exploring and, if successful, developing the Foothills will have a positive multiplier effect on the economy.
   - More players will likely contribute to the earlier commercialization of Alaska gas and the successful completion of the pipeline to Canadian and Lower 48 markets.
   - We do not require all of the State's royalty gas. The remaining royalty gas could be used for future in-State use and for establishing a meaningful royalty-in-value price.
   - AEC is Canada's largest gas producer. One of our core competencies is marketing natural gas in Canada and its interconnected Lower 48 markets. By teaming with AEC, the State will have one of Canada's best producer/marketers working with them. In 2000, AEC had the highest netback gas price compared to the top 23 Canadian producer/marketing companies.
   - If our exploration efforts are successful, we will not need to purchase the State's royalty gas. The State will then be free to re-market the royalty gas to other parties, while receiving all the same benefits mentioned above.

3. **The third question is do we have any specific comments on the terms laid out in the Preliminary Finding.**
   - Since the pipeline has not been built yet and actual gas sales will not occur for sometime in the future, we believe the State should leave as many terms and conditions open as possible for the Bidder. This will allow for maximum creativity and innovation. This should also maximize the potential value available to the State.
   - We believe the proposed royalty gas sale is in the State's best interest and strongly support the Preliminary Finding. Now is opportune time for the State to capture the maximum benefit from its royalty gas.

ANADARKO PETROLEUM CORPORATION P.O. BOX 1330 • HOUSTON, TEXAS 77251-1330 • TEL. 281/875-1101

Anadarko

2001 NOV 16 PM 3 19

November 12, 2001

Alaska Oil and Gas Royalty Development Advisory Board
c/o Alaska Division of Oil and Gas
550 W. 7th Ave, Suite 800
Anchorage, AK 99501
Attn: Mr. Kevin Banks

Dear Royalty Board:

This letter is being sent in support of the Preliminary Finding and Determination for a Competitive Sale of Alaska North Slope Royalty Gas ("Preliminary Finding") issued on October 29, 2001. Anadarko is a strong advocate of the State's efforts to solicit bids for the State's Royalty gas in accordance with the timeline set forth in the Preliminary Finding. The royalty in-kind ("RIK") bid process timing is critical to current, future, and continued natural gas exploration within the State of Alaska.
Securing access to the proposed natural gas pipeline from the North Slope is a necessity for the continued exploration for natural gas within the State of Alaska. We believe that the gas pipeline capacity will be fully subscribed at the outset. Therefore, failure to secure firm transportation now could result in Anadarko's prospective gas discoveries being stranded without any means to produce and sell the gas. However, without proven gas reserves it will be extremely risky for exploration companies, such as Anadarko, to commit to firm transportation services on the gas pipeline. Firm transportation services entail substantial monthly demand charges that must be paid regardless of whether or not the shipper tenders gas volumes to the pipeline. We anticipate that the demand charges associated with the minimum economic field size in the Foothills region will likely be on the order of $180 million per annum.

A RIK bid process would allow an opportunity for an exploration company to purchase the State's royalty gas in conjunction with bidding for firm transportation on the future natural gas pipeline. The RIK bid process timing is critical inasmuch as the Alaska Gas Producers Pipeline Team ("AGPPT") that is studying the natural gas pipeline feasibility has publicly stated that an open season for securing capacity on the pipeline could occur in the first or second quarter of 2002.

Conducting this RIK bid process at this point in time capitalizes upon the substantial current interest in the State's royalty gas from a number of diverse industry players. Since firm capacity is expected to be required to market North Slope natural gas and given the expectation of an early 2002 open season, it is expected that now is the optimal time for the State to secure maximum value for its royalty gas. With numerous expressions of interest in the State's royalty gas, it is expected that the competition for the State's royalty gas will be substantial.

In addition, the RIK bid process creates an opportunity for the State to capture real economic value for its royalty gas volumes years before the State will actually have royalty gas volumes available to sell. The gas pipeline needed to market North Slope gas reserves is not likely to be constructed and placed in service until the 2008 – 2010 timeframe.

Given the Preliminary Finding's requirement for a minimum cash bonus and/or cash option payments, in all likelihood the State will realize some form of substantial compensation for its royalty gas volumes some seven (7) to nine (9) years in advance of production and sales. In addition, certain bid structures may entail commitments to in-state investments as outlined in the Preliminary Finding. Such investments would yield substantial economic benefits to the State in terms of incremental investments, increased tax revenue, new employment creation, and similar socioeconomic benefits.

Lastly, given the basic premise and mandate that any winning bid must yield the State a royalty price of not less than the price it would have otherwise received had it sold the gas as royalty in value ("RIV"), there appears to be absolutely no downside to this initiative by the Department of Natural Resources. By definition and structure of the Preliminary Finding, the State will be revenue neutral at worst, but is mostly likely to generate a substantial incremental value to the State along with acceleration of values and benefits vis-a-vis the RIV option. The economic benefits expected from this RIK bid process will accrue to the State in the form of increased State revenues, employment gains, and potential improvements in the standard of living for Alaskan residents.

Holding this bid process now is both appropriate and critical in terms of optimizing and capitalizing upon the opportunities and competitiveness for the State's royalty gas. A timely process will preserve the maximum number of options for the use of State royalty gas, it will help the State better understand the possible uses for its gas, and as has been described above, it is critical to current, future, and continued Alaska natural gas exploration. As a company keenly interested in bidding for the State's RIK gas we appreciate this opportunity to support the process and provide comments. We are confident that this arrangement will provide significant benefits to and be in the best interest of the State of Alaska.

Respectfully yours,

David D. Anderson
Manager, International Commercial Development

Kevin Banks

From: Ken Thompson [ken@pacrimldr.com]

Sent: Monday, November 19, 2001 2:26 PM

To: krb@dnr.state.ak.us

Cc: Mike Navarre; Ken Freeman; Bonnie Robson

Subject: My Public Comments re; RIK Sale

Thank you for allowing the public to comment on the "Preliminary Finding and Determination for a Competitive Sale of Alaska North Slope Royalty Gas". Below are my personal comments regarding the bidding and potential sale of the State's "royalty in kind" volumes of natural gas from the North Slope.

1) This process, the first of its kind for North Slope RIK gas in Alaska, is being accelerated primarily based on "speculation" that the major producers may hold an open season for nominations in the first quarter, 2002. I suggest a letter from the State be mailed immediately to the three major North Slope producers with a copy to FERC asking these three companies to let the State know by mid-December if an open season is indeed planned for the first quarter, 2002, or not. Also asking this of the new Foothills Pipeline consortium would be wise, in my opinion. While the producers may not tell the State, having documentation either way that the Producers were giving - or not giving - the State adequate real notice would be advantageous to have.

2) The current DNR commissioned study underway by Econ1 regarding the current and forecasted supply/demand for natural gas within the state should be completed and analyzed first before the step of "Publish Final Finding and Invitation to Bid". This may mean that the date of December 12 for the "Publish Final Finding" be delayed some. With analysis of the details in the Econ1 study, the state should assess what portion of the royalty gas must be held off the bid table, or bid but specified for instate use, before the "Final Finding" is mailed. While the "Preliminary Finding" says the state is allowed to keep gas for instate use and that the state will allow only a portion of RIK gas to be bid on, I think it is very important to be more exact. For example, for energy security within the state, it is my opinion that a volume of state RIK gas deliverability from the North Slope be held for replacement of the natural gas shortfall in residential and commercial use from the Cook Inlet. The State should not forecast exploration success in the Cook Inlet to replace this 2006-2008 gas deliverability shortfall which you're aware of, but should be able to fully supply the Anchorage and Cook Inlet increasing gas needs from the North Slope RIK gas or certainly plan to if needed. Considering this, the amount of RIK gas that can be bid on may be less than 250 MMCFD of the total 500 MMCFD if a gross sale is 4 BCFD.

2) For the reason mentioned above and to allow for flexibility for additional bidding packages of RIK gas, it may be wise in this "first pass" of bidding in January, 2002, that no more than 100-250 MMCFD be allowed in this initial bidding package. Bidding in smaller packages is also advantageous in that the State should not want a small gas explorer or producer on the North Slope interested in securing pipeline capacity to "corner" all the available RIK bid capacity or else other smaller explorers would be disadvantaged.

3) I would also suggest with future uncertainty in Cook Inlet gas supply post 2010 that the term of this first bid package be no more than 5 years for the 100-250 MMCFD.

4) If this effort proceeds to bidding and two or more acceptable bids are obtained, the State might choose to accept two bids instead of one to create more future competition for gas marketing, keeping various players interested and involved.

5) It would be advantageous for the State to specify in the "Final Finding" that a North Slope netback wellhead price be presented in a bid for certain volumes. If all bids are quoted as a Lower 48 hub price minus transportation, this still leaves speculation and uncertainty to the netback wellhead price as pipeline tariffs are not yet known. However, if a bidder would step out, take the lead and risk by bidding a netback wellhead price that is acceptable, this would be very significant for Alaska, in my opinion. Such an acceptable absolute price would cross for the first time in Alaska history the "reasonable price" stipulation in the North Slope leases, triggering Producers to also have to consider selling at this price or be in violation of lease terms. This could be

leveraging as these Producers make decisions next year to sell their gas or not.

6) If should be clear that the natural gas liquids in the RIK gas should be separately bid and sold separately based on liquids prices versus a BTU adjusted price.

Please feel free to reply by e-mail or to phone me at 770-1600 if you have questions of me regarding these comments. Thanks again for the chance to provide input.

Sincerely, Ken Thompson
(Past President of ARCO Alaska, Inc. (retired) and currently President, Pacific Rim Leadership Development, LLC)

November 27, 2001

2001 NOV 28 AM Anadarko

Division of Oil and Gas
550 W. 7th Ave, Suite 800
Anchorage, AK 99501
Attn: Mr. Kevin Banks, Petroleum Market Analyst

Re: Preliminary Finding and Determination for a
Competitive Sale of Alaskan North Slope Royalty Gas

Dear Mr. Banks,

In accordance with the provisions of the captioned October 29, 2001 Preliminary Finding, Anadarko Petroleum Corporation submits the following comments for the State of Alaska Department of Natural Resources' and the Alaska Oil and Gas Royalty Board's consideration in the preparation of the "Final Finding" and the related "Invitation to Bid". We would also like to take this opportunity to reiterate our support for this royalty in-kind sales process as set forth in our letter of November 12, 2001 (copy attached).

Although not specified in our November 12 letter of support, we believe that the present is the optimal time for the State to hold this competitive royalty gas sale due in large part to the significant difference between oil pipeline access mechanics and natural gas pipeline access procedures.

Oil pipelines falling under Federal regulations operate as "common carriers" by which all parties seeking transportation are afforded access on a *pro rata* basis. However, natural gas pipelines covered by Federal jurisdiction function as "contract carriage" pipelines. Contract carriage pipelines contract out capacity to potential shippers for fixed terms. Shippers can secure capacity on a "firm" basis meaning such capacity is exclusively available to such shippers. If the pipeline contracts all of its effective capacity under "firm" arrangements, no capacity would be available to subsequent shippers seeking capacity.

We anticipate that the proposed Alaskan gas pipeline serving the North Slope will be fully subscribed with firm service shippers during the open season process. Once all of the pipeline's capacity is let as the firm service, the universe of practical potential State royalty gas purchasers will be fixed to the limited number of shippers successfully securing such firm transportation capacity.
Therefore, in order to ensure that the maximum number of parties compete for the State's royalty gas and thereby ensuring the most attractive bids, the State is correct in proceeding with this bid process before the pipeline open season. After the open season and probable allocation of all of the pipeline capacity on a firm basis, there will likely be fewer potential bidders for the State's royalty gas.

Our questions and comments related to the Preliminary Finding are as follows:

1. **Quantity:**

Section I. C. on page 4 of the Preliminary Finding indicates that the "Invitation to Bid" will specify the quantity of gas offered for sale. In order to retain the maximum creativity of the potential proposals in response to the Invitation to Bid, we suggest that the State not limit the quantity of royalty gas to be made available, at least not at this early stage of the process. It is further suggested that if any quantity limit is imposed, that such limit be set at the absolute highest volume reasonably acceptable to the State.

2. **Term:**

As with quantity above, we believe that leaving the term unspecified in the "Invitation to Bid" will allow for more creativity in the potential bids. However, Section II.C. in the Preliminary Finding lends some confusion as to the length of an acceptable term. Section II.C. references a preference for a relatively short term, yet indicates that a term commensurate with the term of the firm transportation may be acceptable. We believe that it would be mutually beneficial to provide greater guidance as to an acceptable term length in the Final Finding and the Invitation to Bid. However, we recommend that an absolute term maximum not be set out in the Invitation to Bid as it may reduce bid creativity.

3. **Delivery Point:**

Section II.C. in the Preliminary Finding indicates that the delivery point will be defined in the Invitation to Bid. Section III.A. of the Preliminary Finding indicates that there are a number of generic locations that could be established for the Point of Delivery. The selection of the Point of Delivery is a critical matter and it may be more appropriate to defer a final determination of the Point of Delivery until negotiation of the definitive gas purchase and sales agreement following bid award.

It is anticipated that the natural gas subject to this bid process will require conditioning for the extraction of diluents; specifically CO_2. As such, it may be better for the State to secure conditioning services for the royalty gas prior to delivery to the purchaser, as the State will likely have more leverage than the buyer in negotiating fair and reasonable conditioning fees.

4. **Proposed RIK Gas Supply Contract:**

Section I.C. indicates that an RIK gas supply contract will accompany the Invitation to Bid. We recommend that the Final Finding and Invitation to Bid clarify that the subject contract will be a basis for contract negotiations and not non-negotiable. Also, in an effort to shorten the fairly substantial time required to finalize this bid process, we would recommend that the subject contract be tendered to potential bidders as soon as practicable in order that constructive comments may be provided by potential bidders.

5. **Allocations of RIK Volumes:**

The next to last paragraph in Section I.C. leaves open the potential for multiple awards of RIK gas volumes. We would like to take this opportunity to observe that for a number of bidders, there is a minimum quantity of RIK gas required in order to satisfy the bidders' objectives for the RIK gas. For some bidders, such as ourselves, the minimum quantity is quite substantial. We would caution against the inclination to make multiple awards in an effort to appease numerous bidding parties at the risk of undermining the needs of legitimate bidders requiring large quantities to fulfill their needs.

Given our concern as to minimum volumetric thresholds, we request that the Final Finding and Invitation to Bid contain a provision that allows a successful bidder to withdraw its bid if it is awarded a quantity substantial less than the quantity bid for.

6. **Propose No Bidder-Initiated Contact After Bid Opening:**

Given the fact that the terms of all bids will be publicly announced at the "Bid Opening", we recommend that the Final Finding and Invitation to Bid expressly state that no bidder may initiate contact with the Division of Oil and Gas or the Alaska Oil and Gas Royalty Board after bids are revealed at the Bid Opening. We are concerned that absent such a pronouncement, there will be substantial temptation for bidders to enhance their bids based upon the information disclosed by competing bids revealed at the Bid Opening.

7. **Minimum Cash Bonus Bid:**

It is unclear whether this bonus is only assessed against the winning bidder, or whether this is a non-refundable payment due from all bidders as a prerequisite to bidding. This point should be clarified in the Final Finding and Invitation to Bid. Our preference would be that such payments would be refunded unless the bidding party is awarded RIK gas purchases.

8. Base Price Determination:

We suggest that the Final Finding and Invitation to Bid clarify that the RIK gas price paid will not be used in the determination of the RIV gas price. Per Section II.A. of the Preliminary Finding, the RIV gas price is computed based upon the higher of a number of valuation criterion, including the prices received by producers in the field.

By definition, the RIK price will be higher than the RIV price inasmuch as the RIK price will include a premium price added to the RIV Base Price. This creates a circular process wherein the RIK premium price could be factored into the RIV price thereby escalating the RIV and RIK prices without end.

This circular deficiency also arises if one or more of the dominant North Slope gas producers is awarded purchase of the State's RIK volumes. The Base Price for purposes of bidding for the RIK gas is the weighted average RIV price resulting from the sale of North Slope gas. The three largest North Slope gas producers hold over 90% of the proven gas reserves on the Slope. As such, their respective gas sales prices will be prominent in the determination of the RIV sourced Base Price. If one or more of the dominant North Slope gas producers is awarded RIK gas purchases, there could be incentive for that party to manipulate the RIV price in order to minimize the RIK Base Price.

9. Base Price Determination Intent:

Section II.A of the Preliminary Finding contains a discussion of the Base Price determination and in particular the "netback" nature of determining the RIV price. We believe that it would be mutually beneficial to incorporate such a discussion in the Final Finding as well. In fact, we believe that further clarification in the Final Finding, Invitation to Bid, and draft gas supply contract could serve to reduce ambiguity and potential dispute as to the intended determination of the RIV price.

Inasmuch as the RIV price represents the Base Price for RIK pricing, accurate understanding and application of the RIV price is of paramount importance. Any further explanation and/or language that could serve to reduce some of the uncertainty in the determination of the RIV price would serve all interested parties well.

10. Limitation on Base Price Redetermination:

Section II.A of the Preliminary Finding addresses the fact that the RIK Base Price may be subject to modification through audit and dispute resolution for years. In order to limit some of the risk associated with the uncertainty of and administration of the RIV Base Price, we request that the Department of Natural Resources and the Alaska Oil and Gas Royalty Board seriously consider adopting a reasonable statute of limitations for adjustment of the RIV price to be used as the Base Price for RIK gas pricing. We would suggest a two-year audit cutoff and limit any adjustments beyond the two-year audit constraint to those adjustments arising out of resolution of audit claims which occurred within the two-year audit cycle.

11. **In-State Investment Performance Obligations:**

The last paragraph in Section II.B. of the Preliminary Finding outlines the potential remedies for the State in the event a bidder fails to carry out in-State investments contained within the bidder's RIK purchase proposal. Given the fact that in-State investments could be given material weighting in the evaluation of bids, we recommend that the Final Finding and Invitation to Bid documents adopt one or more of the more punitive recourses set out in the Preliminary finding.

In particular, there would not appear to be much downside risk to embellishing and/or reneging on in-State investment elements of one's bid if the only consequence for failure to perform such investments was a cancellation of the sales contract, or a reduction in sales volumes.

12. **Delivery Quantity:**

Section II.C. of the Preliminary Finding states that the prospective buyer must be willing to accept the risk of receiving more or less than the desired quantity. We suggest that this concept be softened somewhat in the Final Finding and Invitation to Bid documents. In the event the State's RIK volumes exceed the expected volumes, the buyer may be operationally precluded from purchasing the excess volumes if such volumes exceed the buyer's firm transportation capacity and no interruptible transportation service is available on the pipeline at the time.

We would suggest that the Final Finding, Invitation to Bid, and draft gas supply contract address this situation such that the buyer would be under a best efforts obligation to purchase such excess volumes.

13. **RIK Supply Source:**

The last sentence of Section II.C. affords the State the right to supply the contract quantity of RIK gas from either or both the Prudhoe Bay Unit and the Point Thomson Unit. Given the potential differences between the handling of Field Costs between these units, such unlimited discretion could be materially detrimental to the buyer.

It is our understanding that the purchaser will have to bear Field Costs for some Point Thomson Unit volumes attributable to Form DL-1 leases. If we understand the issue correctly, if the State receives royalty in-value from the subject Point Thomson leases, the State does not have to bear Field Costs. If, however, the State takes its royalty volumes attributable to these leases in-kind, the State must bear the associated Field Costs.

We would suggest that unless and until such time as the State's total RIK volumes reach a volumetric level requiring the taking of gas from such leases, it would be in both the State's and the purchaser's best interest to preferentially take RIK volumes from those leases not affected by this Field Cost issue.

We would suggest that the Final Finding, Invitation to Bid, and draft gas supply contract address this situation such that, to the extent possible, RIK volumes shall first be sourced from available State RIK volumes other than those attributable to DL-1 leases within the Point Thomson Unit. If, however, the total State RIK quantities being sold to all purchasers requires the taking of volumes from Point Thomson Unit DL-1 leases, then such more costly Point Thomson Unit DL-1 lease RIK volumes shall be allocated to all RIK gas purchasers on a *pro rata* basis.

For instance, if the PTU DL-1 leases represent five percent (5%) of the total available State North Slope RIK gas volumes, then five percent (5%) of the RIK gas allocated to the purchasers should be attributable to PTU DL-1 lease gas.

14. Conditions Precedent:

We would suggest that the Final Finding, Invitation to Bid, and draft gas supply contract contain the added condition precedent that if no open season has occurred prior to April 30, 2005, either buyer or seller may terminate the contract and commitments made by the respective parties.

In addition, given the real potential for substantial delays in the construction of this pipeline that may be well beyond the reasonable control of the State and buyer, such as an inability to secure rights-of-way across First Nations lands in Canada, we would suggest that the 2011 pipeline completion stipulation be revised along the lines of:

> "Either party may terminate the contract and shall be under no further obligation to the other party in the event that an ANS gas pipeline has not been placed in-service by December 31, 2011. Provided, however, if buyer has secured firm transportation service on the pipeline for RIK gas purchases and is unable to terminate its firm transportation obligations with the pipeline despite its best efforts to do so, the State agrees that it will defer its right to terminate the RIK gas purchase contract for a two year period ending December 31, 2013."

15. Field and Conditioning Costs:

We suggest that the language set out in Section III.B should be revised consistent with our comment No. 3 above concerning the location of the Point of Delivery. As we understand the Field Costs situation, through various settlement agreements, the State bears its proportionate share of Field Costs as to royalty gas volumes from the Prudhoe Bay Unit regardless of whether the State takes its gas in-kind or in-value. However, under certain leases within the Point Thomson Unit, the State does not bear its proportionate share of Field Costs as to royalty taken in-value, but does bear these costs for volumes taken in-kind.

We recognize the State's requirement that any RIK sales must yield the State a value equal to or greater than the value the State could have otherwise received through sales of royalty gas in-value. We further recognize that any RIK gas sold which bears a Field Cost that the State would not have otherwise incurred must be borne by the buyer. However, we believe clarification of this point is warranted in the Final Finding, Invitation to Bid, and draft gas supply contract.

However, we are unclear as to whether or not the State bears its proportionate share of gas conditioning costs under the terms of the leases held by the unit owners. If the costs associated with gas conditioning do not follow the same logic and process set out above for Field Costs, then the appropriate handling of these costs need to be addressed in the Final Finding, Invitation to Bid, and draft gas supply contract.

The handling of Field and Conditioning Costs is a complex matter and is interrelated with the established Point of Delivery and the disbursement of proceeds procedures. We suggest that this complex issue be better developed in the Final Finding, Invitation to Bid, and draft gas supply contract.

At a minimum, we believe that the Final Finding, Invitation to Bid, and draft gas supply contract should clearly state that the Base Price derived from the weighted average RIV price is intended to reflect the netback market price for North Slope natural gas sales, after deduction of all actual pipeline tariffs, treating and conditioning fees, and Field Costs that are normally borne by the State in a royalty in-value sale. The buyer shall only be responsible for keeping the State whole as to Field Costs related to quantities of gas attributable to leases that would not bear such costs in a royalty in-value mode.

16. Default Notice and Termination:

The timing set forth in the second bullet point in Section III.E. of the Preliminary Finding is unreasonably restrictive. In all likelihood, the winning bidder under this process will be a large company. Given the substantial segregation of duties within large organizations it is unreasonable to grant the

State the right to suspend performance or terminate the contract if the buyer fails to make full payment within **one** day's notice that payment is past due.

We strongly recommend that the Final Finding, Invitation to Bid, and draft gas supply contract address this issue with a more reasonable default timeframe. In a large organization it is very likely that a default notice may not reach the attention of levels of management empowered to facilitate such payments within the one day timeframe set forth in the Preliminary Finding.

17. Interpretation of Terms and Conditions:

We request that the language contained in Section III.G. in the Preliminary Finding addressing dispute resolution be modified in the Final Finding, Invitation to Bid, and draft gas supply contract to clarify that the Commissioner's finding may be appealed in court. As currently drafted, it appears that the Commissioner's finding is final. Inasmuch as the Commissioner serves a critical role in the negotiation and application of the RIK gas sales contract in his/her capacity as a representative for the State, his or her findings may fall short of a disinterested, objective assessment of any dispute under the terms of the contract.

18. Other Provisions – Preservation of Intent:

The last sentence in Section III.G. of the Preliminary Finding indicates that the gas sales and purchase contract will contain a provision to facilitate modifications to the contract in order to ensure preservation of the parties' intent should changes in the market occur during the course of the contract. We support such a clause provided that the language is constructed to the mutual satisfaction of both the State and the purchaser.

The State should recognize that any RIK purchaser will be required to secure transportation services for the RIK purchase volumes and such transportation services are likely to carry substantial demand charges (ship-or-pay provisions). Therefore, it is imperative that the purchaser be afforded as much contract certainty as is reasonably possible. We strongly suggest that at a minimum the application of any such "intent preservation" provision be limited to market changes that have a material detrimental impact on the affected party.

19. Section IV. - Analysis of State Benefits:

We recommend that the next to last sentence on page 12 of this Section of the Preliminary Finding be clarified in the Final Finding. Our concern is that the mere purchase of the RIK gas may provide incentive for the purchaser to make in-State investments that it might not otherwise make. We believe the intent of the sentence in question is to state that such in-State investments cannot be induced by subsidization through below-market RIK sales terms. In fact, the preceding sentence makes specific reference to subsidization prohibitions. We simply request that the Final Finding clarify that an RIK sale alone, which results in incremental in-State investments is not contrary to State regulations so long as such RIK sales terms are not below-market or subsidized.

We thank you in advance for your consideration of these comments as you move forward in the drafting of the Final Order, the Invitation to Bid, and the drafting of the pro forma gas purchase and sales contract. Should you have any questions concerning these comments, please feel free to contact me at 832-636-7139, or Angie Kelly at 832-636-7196.

Respectfully yours,

David D. Anderson
Manager, International Commercial Development

H:Alaska/Foothills/Preliminary Finding Comments – 112501

PHILLIPS Alaska, Inc.
A Subsidiary of PHILLIPS PETROLEUM COMPANY

P. O. BOX 100360
ANCHORAGE, ALASKA 99510-0360
Phone (907) 265-6517

Joseph P. Marushack
Vice President, ANS Gas Commercialization

November 30, 2001

Mr. Kevin Banks, Petroleum Analyst
Department of Natural Resources, Division of Oil and Gas
550 W. 7th Ave. Suite 800
Anchorage, AK 995801

RE: Preliminary Finding and Determination for a Competitive Sale of Alaska North Slope Royalty Gas, dated October 29, 2001.

Dear Mr. Banks:

On behalf of Phillips, thank you for the opportunity to comment on the subject preliminary finding. Our comments fall into two areas: timing of the process and impact to owners of known resources.

Relative to timing, it appears to us that the royalty sale activity does not need to be so quickly paced. The preliminary finding and DNR staff comments at the November 13, 2001 public meeting both indicate that the timing of the RIK sale process is being driven by an expectation that the work of the AGPPT could result in an open season as early as January, 2002. As we have frequently indicated, the Project Team has been working to develop an economic project, obtain Federal enabling regulatory legislation and to progress a framework for fiscal clarity within Alaska. Although progress is being made in Washington, DC, the federal legislation is unlikely to be available before sometime later in 2002 . Therefore, we do not foresee holding an open season during 1Q 2002. In fact, it is pre-mature to make any near-term estimates on when an open season might occur. Consequently, we suggest that any RIK sale process be deferred pending greater definition in this area.

Next, we recommend that the findings be expanded to fully consider additional potential impacts.

One of the stated reasons for the royalty gas sale is to provide RIK gas as a "back-stop" to gas production that companies with unexplored leases on the North Slope hope to develop. This means that if an RIK purchaser were to exercise its option to stop buying RIK gas, the existing resource owners would suffer a reduction in delivered volumes of equity gas and likely under-utilization of the gas treatment plant and any other on-lease investments made expressly for gas sales. It is the known resource owners who must make the base, long-term, throughput commitments for any pipeline project to be developed. As such our net volume must be known and not subject to reduction. The State's RIK proposal clearly seeks to transfer the benefits of those long-term commitments to new participants without transferring the associated risk. Our fundamental concern is that this will further burden the economics of the overall project and add uncertainty at a time when we have yet to realize an economic way forward.

We believe that fair and unbiased capacity allocation and expansion procedures, as achieved through the FERC regulatory process, will assure that all gas producers, both present resource owners and potential explorers, have adequate access to transportation capacity. While the backbone of the project will be for existing reserves to be developed, the ability to expand capacity has always been a priority for Phillips and in the joint producer work effort. Creation of and access to such expansion capacity should better occur under an open and non-discriminatory basis as new sources of supply are identified and the markets demand.

Thank you for the opportunity to present these comments on the subject finding. If you desire, we would be happy to follow up these general comments with additional information. If you have any questions or concerns, please do not hesitate to contact me directly at (907) 265-6517.

Sincerely,

Joseph P. Marushack
Vice President, ANS Gas Commercialization
Phillips Alaska, Inc.

bp

BP Exploration (Alaska) Inc.
900 East Benson Boulevard
P.O. Box 196612
Anchorage, Alaska 99519-6612
(907) 561-5111

November 30, 2001

Mr. Kevin Banks, Petroleum Analyst
Department of Natural Resources, Division of Oil and Gas
550 W. 7th Ave. Suite 800
Anchorage, AK 995801

RE: Preliminary Finding and Determination for a Competitive Sale of Alaska North Slope Royalty Gas, dated October 29, 2001.

Dear Mr. Banks:

On behalf of both BP Exploration (Alaska) Inc. and our Gas & Power group, I would like to thank you for the opportunity to provide both written and verbal comments on the subject preliminary finding. I hope you and the other DNR staff found our meeting on November 14 beneficial.

<u>Timing</u>
The preliminary finding as well as comments at our meeting both indicate that the timing of this proposed RIK sale is being driven by the perception that the Alaska Gas Producers Pipeline Team may hold an "open season" for pipeline capacity as early as January 2002. We do not foresee any possibility of holding an open season during 1Q 2002 and apologize for any miscommunication in this regard. Indeed it is presently unlikely that an open season will be held anytime during 2002 unless some important government actions are progressed.

As we have stated previously, for a gas pipeline to attract investment, there must be an economic project and there must be a predictable and viable government framework in place to support investment. Both federal regulatory legislation and clarity around State tax and royalty are important pieces of this government framework.

AGPPT is currently working diligently to engineer and design a modern day gas pipeline with competitive tariffs to market, however to date costs are trending above where they need to be. Progress is being made in Washington DC on the enabling regulatory legislation, but current prognosis suggests it is unlikely that it will be available before sometime later in 2002. Finally, much work remains on progressing a framework for fiscal certainty with the State of Alaska and this proposed RIK sale actually highlights the uncertainty of the current fiscal framework under which we must evaluate the economics of this project.

Impact on the Economic Viability of Pipeline Project
As currently structured, this RIK gas sale is being pursued to provide a free capacity access option to parties without proven gas reserves. If the sale proceeds with an option to switch between RIK and RIV on short notice, overall project economics would be materially burdened by the uncertainty in equity gas sales volumes of the known resource owners who will need to make binding contractual commitments to ship gas for many years. This burden on an already marginal project is a clear step in the wrong direction. Such a burden would make it unlikely that producers would subscribe to any open season unless financially compensated for the burden.

For example, an RIK purchaser could use its purchased gas as a backstop for making a firm transportation commitment on a gas line. The balance of the FT commitments to get the line built would be made by the known resource owners. Should an RIK purchaser discover its own gas resources, it could cancel its purchase contract with the state and substitute its own gas into its FT commitment. The State's gas would then revert back to the known resource owners in the form of RIV gas thus reducing the amount of equity gas that the resource owners could export via their own fixed-volume of FT commitment. This reduction would result in a loss of revenue to the known resource owners as well as result in the probable under-utilization of asset investments made at the lease level.

The State's RIK proposal clearly seeks to transfer benefits from long term investors to new participants without transferring the risk associated with the massive investment that will be required to make any gas pipeline a reality. Such subsidies at the expense of those who will ultimately underwrite any new build pipeline are both unfair and, more importantly, reduce the chances of developing an economically viable project.

We believe that fair and unbiased capacity allocation and expansion procedures already exist through the FERC regulatory processes. These processes will be sufficient to assure that all gas producers, both present resource owners and potential explorers, have adequate access to transportation capacity. If the State has reservations in this regard, we are prepared to discuss this further or to meet jointly with FERC officials to gain a full understanding of how FERC ensures fair and consistent rules of access are developed and administered.

Efforts to fix a problem that doesn't exist with economically burdensome solutions cannot be in the best interest of the State, especially if those solutions could cause a gas pipeline project not to proceed at all.

We and AGPPT have discussed this matter with the State previously and we believe our discussions on this matter have been consistent. However, we regret if we have not been clear and hope this letter will help provide additional clarity.

We respectfully request that the state refrain from taking steps that will further jeopardize the commercial viability of a pipeline project.

<u>Prospective Bidding</u>
The above discussion should not be construed to mean that BP is in anyway opposed to the State marketing its royalty gas. Indeed, in the event the State wishes to market its gas in a manner consistent with fair market principles and consistent with the long-term firm transportation commitments necessary, BP could provide a fully competitive offer.

In many respects, a properly structured RIK sale could actually address part of industry's concerns around fiscal stability. Clear and transparent pricing for royalty gas would be an important step towards the fiscal clarity industry is seeking.

We would be happy to follow up these general comments with additional information and discussion at any time. Please do not hesitate to contact me directly at (907) 564-5553.

Sincerely,

CJ Coulson

Charles J. Coulson
Commercial Manager – Alaska Gas
BP Exploration (Alaska) Inc.

cc: David Welch
Ken Konrad
Pat Pourchot
Ken Freeman

AEC MARKETING (USA) INC.

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rec'd via email on
12/6/01

November 27, 2001

Department of Natural Resources
Division of Oil and Gas
550 West 7th Ave, Suite 800
Anchorage, Alaska
99501-3560

Attention: Kevin Banks
Petroleum Market Analyst

Re: Preliminary Finding and Determination for a Competitive Sale of Alaskan North Slope Royalty Gas

This letter is in support of Anadarko Petroleum Corporation's comments for consideration in the preparation of the "Final Finding" and the related "Invitation to Bid", as stated in their letter dated November 25, 2001 addressed to Kevin Banks.

AEC strongly advocates the sale of royalty-in-kind gas and the timeline and process set forth within the Preliminary Finding. We believe initiating the royalty-in-kind process and finalizing the awarded gas sales contracts as soon as possible is critical for current and future gas exploration within Alaska.

AEC and Anadarko are prepared to be active explorers for natural gas on the North Slope, provided we have access to the gas pipeline. Our efforts and activities will create competition and attract other gas players, which in turn will increase the State's revenue (e.g., royalties, land sales). We believe this is something unique to new explorers, which the Alaska Gas Producer Pipeline Team can not provide. An example supporting this view is BP's announcement on shutting down their frontier exploration in Alaska and switching to harvest mode.[1] AEC also believes Phillips' exploration will slow in Alaska due to their Conoco merger. We want to emphasize that when you consider the Royalty in Kind bids, there is significant upside benefit to the State that that will come from not only price premiums, but from the exploration activities of new players.

We reiterate our support for this royalty in-kind sales process as set forth in our testimony to the Royalty Board on November 13, 2001. If you have any questions, please contact Alan Sharp at (403) 261-2560.

Yours truly,

Alan Sharp
Director, Northern Business Development

[1] Petroleum News Alaska. Vol.6, No.18. Page 1, "What will it take to get BP's focus back on Alaska?".

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DEC 11 2001

DIV. OF OIL & GAS
DIRECTOR'S OFFICE

Williams

December 6, 2001

Mr. Pat Pourchot
Commissioner
State of Alaska
Department of Natural Resources
Division of Oil and Gas
550 West 7th Avenue, Suite 800
Anchorage, AK 99501-3510

Reference: ***Williams Comments Submitted to The State of Alaska regarding the Preliminary Finding and Determination for a Competitive Sale of Alaska North Slope Royalty Gas* ("Preliminary Finding")**

Dear Mr. Pourchot:

It is with great pleasure that Williams Energy Marketing & Trading submits comments to the State of Alaska pursuant to its request regarding the Preliminary Finding. We have reviewed the Preliminary Finding and respectfully submit the following comments and recommendations, which will become a part of the Published Final Finding and Invitation, scheduled to be published December 12, 2001:

1. ***Section I – Introduction and Background***
   D-Schedule

   A. Proposed Schedule for the 2002 ANS RIK Natural Gas Sale

   Williams Comments and/or Recommendation:

   In our review of the Proposed Schedule for the 2002 ANS RIK Natural Gas Sale, we feel it is extremely restrictive and may be very difficult to administer by the State of Alaska. Williams recognizes the time constraints due to legislative approvals.

2. ***Section II – Developing Bid Proposals for The RIK Sale***

   A. To be considered, proposals must meet the following Minimum Cash Bonus Bid and Base Price Conditions

Williams Comments and/or Recommendation:

The proposed requirement to provide a Cash Bonus Bid is not a normal industry standard. The standard to qualify bidders is typically handled through a type of "Pre-Qualified Bidders Process" to screen for RFP bidders, which meets the desired criteria. Due to the preliminary nature of the pipeline project, a Cash Bonus is premature. However, as the pipeline develops as a viable project, Williams would entertain providing a Cash Advance with certain provisions for recovery.

3. *Section II – Developing Bid Proposals for The RIK Sale*

C. The following terms should be included in all proposals - Quantity and Transport Risk

Williams Comments and/or Recommendation:

Quantity and Transport should mirror each other in marketing your State Royalty Gas.

4. *Section II – Developing Bid Proposals for The RIK Sale*

C. The following terms should be included in all proposals - Term

Williams Comments and/or Recommendation

Term and Transport should mirror each other in marketing your State Royalty Gas. The industry standard transportation contract on a new proposed pipeline usually has a minimum term of ten (10) years. Williams' recommends that the State would need to evaluate longer-term structures for their sale of RIK.

Due to our recommendations related to the Cash Bonus Bid our comments are being submitted without a cash advance. I have attached a Williams Overview, which is the information we provide to our customers to Qualify Williams for Bidding. Williams Corporate Credit Rating is BBB+ rated by Standard and Poors Corporation. I have also included for your review Williams' Bank and Trade References.

We are extremely interested in marketing the State of Alaska's Royalty Gas. In addition, Williams is also interested in working with the State of Alaska and the Producer Consortium in a unified effort toward Commercializing the Alaska North Slope Gas. As you know, Williams has a full-time team dedicated to the Alaska North Slope Project.

Williams is extremely cognizant to the State's requirements for bringing In-State Value through this project. In addition, we feel we can provide some creative ideas to market the States Royalty Gas by providing increased value over RIV.

If you have any questions or need additional information, please feel free to call me at 918.573.3603 (office) or 918.645.7409 (cellular).

Sincerely,

Tamara J. Walden
Strategic Business Development
Vice President

TJW/tw

Attachments

Cc: Mark Myers, Director
Bonnie Robson, Deputy Director
Kevin Bank, Petroleum Market Analyst