

Stranded Gas Hearings (0410140930 Minutes)

The Process of and Criteria Used in Making a Decision on Whether to Invest in an Upstream or Midstream Project – October 14, 2004.

*Ken Thompson, Past Executive Vice President, ARCO, and Past President ARCO Alaska;
Joe Marushack, Vice President of Alaska Gas Development, ConocoPhillips Alaska, on behalf
of producers BP, ConocoPhillips, and ExxonMobil*

CO-CHAIR SAMUELS thanked Mr. Brintnell for his presentation and introduced Mr. Ken Thompson, past Executive Vice President of ARCO and the past President of Arco Alaska, and Mr. Joe Marushack, Vice President of Alaska Gas Development, ConocoPhillips Alaska. He noted that Mr. Marushack would be presenting on behalf of ConocoPhillips, BP and Exxon Mobil. He informed members that Mr. Thompson would be giving two different presentations and wearing two "hats" so he asked members to limit questions to the specific presentation entitled, The Process of and Criteria Used in Making a Decision on Whether to Invest in an Upstream or Midstream Project.

MR. KEN THOMPSON explained to members that he would be wearing the hat of an ex-ARCO Executive Vice President, having sat and participated in meetings of that corporation for his last two years at ARCO, and that he would also be arguing for capital for Alaska as President of Arco Alaska from 1994 to 1998 and explain how projects got prioritized on the capital allocation list of that corporation. He said he is currently serving on the audit committees of the boards of directors of Alaska Air Group and the Coeur D'Alene Mines Corporation, where he oversees capital allocations. He began:

How did large corporations like an ARCO make decisions? How did capital get approved when projects were commercial? Not all projects that were commercial were approved. There is a finite amount of capital that any company can spend, as I'll describe in a moment.

Before I get into that, I'm going to briefly talk about something that's extremely important from the discussions yesterday. Those were ... [end of tape]

MR. THOMPSON continued:

... or helped oversee signing of joint venture agreements for natural gas development and pipeline development with Malaysia. It was joint venture LLCs, profit sharing, as well as they took equity participation. I also signed similar joint venture participation agreements in the country of Thailand - also, in the country of Indonesia, where ARCO had a lot of operations. All the deals we made there in development [were] equity participation by the government company, as well as production sharing and profit sharing. I also signed deals in Trinidad natural gas and also deals in the country of Qatar in the Middle East. All of these deals were, in fact, what Pedro Van Meurs talked about yesterday.

These were deals that ARCO moved ahead on on natural gas development, where those countries took an equity participation and I recommend that the legislature also approve that Alaska this time changes the business model, that this time, Alaska takes an equity participation in the pipeline - at least your 12.5 percent share to more or less obtain the tariff profits on your royalty share of gas. I've also been recommending for two years that the state take its royalty gas in-kind and you get in the market and you see what you can do, whether it's your own little division that you set up with experienced gas marketing or you can contract that out to very viable excellent gas marketing firms.

These decisions are very important. I also found very important, and it was very significant, and I don't know if all of us fully understood the impact of what UBS was saying yesterday and Lehman Brothers were saying yesterday. After the federal legislation was passed, where the federal government will guarantee the debt, capital markets will flow to this particular project now. It is financeable. And, it will lower the risk substantially on anyone because the state, for your share, will put in 20 percent equity and the rest is - and this is significant - it is project debt, non-recourse back to the state or the corporations. You'd have to make sure that [indisc.] happen but the

likelihood of that is higher now that you have those loan guarantees.

On a shelf in my living room, which I'm very proud of, is a beautiful clock that was given to me by the Prime Minister of Malaysia and the Prime Minister of Thailand for ARCO signing a joint venture agreement with those two countries for a gas pipeline from the central part of the Gulf of Thailand and development of a huge gas field there that's underway. It was an equity sharing where they take equity ownership and it's also profit sharing. And I hope someday you all have clocks because we've done the same thing here in Alaska and this time you better take the profits of transporting your own gas rather than paying it to owners out of state.

Now let me get to this other subject, which is how to pen these - how to get these on the capital allocation of these major corporations. So I want to talk about what is the importance of capital budgeting and allocation in a corporation. How do they decide what projects to do? What is the framework that executives in different locations like this one understand that process? What is the investment criteria they use, the sensitivity they look at? And then what are the risks they may look at and what are the common techniques of risk mitigation because we have to answer that risk mitigation. You heard every speaker talk about that yesterday and you hear me talk about it. That will be how we mitigate the risk, such as taking equity participation, such as sharing part of the risk involved with the other investors could make this project go forward.

I'll also talk about something that in the press and in speeches that gets thrown out somewhat haphazardly, and there is a big difference. I'm going to talk about commercial rate of return and competitive rate of return - it's very significant to understand the difference, and then just wrap up with some conclusions or recommendations.

I've already talked about experience with capital portfolios serving on a couple of boards, also serving on corporate boards, also with experience in ARCO that I've already mentioned. At one time I was also manager and resource planning for ARCO, which the sole function was capital allocation of budget - that was it. It is one of the most significant financial activities a firm does. It really determines the core activities of the firm over a long-term future. It confirms which projects receive capital to proceed timely and which ones do not receive capital. A very important point, a controversial point sometimes, but it's simple to understand - not all projects that are commercial or even competitive are approved internally when capital is constrained. When there's not enough cash to go around, not everything gets done. How do we make sure in such a world that the Alaska project makes it on the list? And the capital constraints do force an allocation process - I worked 26 years for ARCO. In those 26 years, not once did all the projects that we had on our list get approved because it was more capital than we had available. Most companies and large corporations are that way.

Decisions must be made carefully and rationally with owners, and this is important, with shareholders in mind. Why does a shareholder invest in Exxon Mobil or ConocoPhillips, a past ARCO, a BP - and it's important to understand why they invest in that versus - and then what the shareholders want to see out of an Enbridge and a TransCanada, because that impacts the capital allocation decisions.

This is an interesting - in slide 5, really the capital budgeting fits into the financial planning of a corporation. The overall financial goal, if a business wants to stay in business, is maximize the shareholder wealth - the stock price increases and the dividends is earning enough return for that shareholder or they'll exit and take their money out of the business by selling their shares. So really, when a chief financial officer gets all this cash in, this last - in the year 2003, at relatively lower oil prices, in the 30s, not the 50 bucks we're seeing now, the CFO of Exxon Mobil was looking at this chart and said how do I spend the \$30 billion cash flow I got in 2003? BP said how do I spend my \$20 billion cash flow? After everything else, how do I invest the \$20 billion I got left from my revenues minus all my expenses - of all fields, of all overhead, I've got \$30 billion. Where do I spend it? I've got \$20 billion at BP and I have \$10 billion, just under 9.8 actually, was for

ConocoPhillips last year. I haven't looked to see - some of those numbers may be doubled this year with oil prices. I don't know.

So how do you decide? You have to allocate between the pots. You have to make an investment decision of the capital - what projects, long-term, short-term, but you also have to make very important dividends - how much of that cash flow will go back to shareholders in terms of dividend that can prop your share price up or also many investors want to see that dividend - maybe see that dividend increase over time. You need to pay those owners.

But I want to talk about the one box about investment decision capital budgeting. You see, the cash flow - when you see a lot of cash, not all of it can come for projects. Shareholders want a big piece of that and they do deserve it in the dividends that are paid. Also that CFO, when they're looking at it, we'll talk about the debt equity mix. How much debt is safe? How much debt is unsafe? Looking at projects, how much equity, and we certainly heard UBS and Lehman Brothers talk about those debt equity ratios yesterday on this project. Whether it's 20 percent equity put in, the rest is debt guaranteed by the federal government, is a sweet deal. I have not seen one like that come along in a long time.

Broad framework for capital budgeting - again, the maximized shareholder - and when projects go through, and when I was a young engineer looking at projects, we understood there were different phases. One, it was an idea. You're sitting around the table, an idea comes up for exploration or midstream, yes?

REPRESENTATIVE CROFT asked, "On the overall - so, a producer that knew that this was a possible commercial venture - that the pipeline was commercial - if it knew it would also have an adverse impact on the overall gas prices for the next 15 or 20 years, I mean how is that internally computed? There's a plus and minus. It will make some money on the one end but it will lower the return I would get for my LNG projects or others. How are those rationalized?"

MR. THOMPSON said the decision is very difficult because the companies must also take into consideration that delaying a project for three years might prevent an impact on gas prices on the rest of their gas, yet if that project is delayed, other competitors could bring in LNG. He said producers should be very concerned that if enough gas supply is not brought, gas prices could get to a point where a lot of fuel switching to other resources could take place and people might conserve more effectively. In addition, if different countries cannot grow their economies because prices are too high, the demand could be dampened. He continued:

So, if you don't get your gas on the market, prices go too high, you could dampen demand for the rest of the gas. That's going to happen anyway and there's ways of calculating that. You know, DOE mentioned that if gas was brought on by 2012, gas prices would decline by about 25 cents, I think was the report if I recall right. On the other hand, other factors could cause the same thing. So it's a tough balance. You mitigate the risk is one way, and we'll talk about it later.

So we have the idea phase. Then you start doing the preliminary evaluation and on something this massive, you put people on it, you spend money. Producers, for example, spent, as you all well know, \$125 million. I would say that would be in the preliminary evaluation phase.

Now we're about to approach a decision sometime and I hope the decision is made by the end of 2005. It was also very significant, a subtle point that didn't get reported by the press here, another very important point in that federal legislation was the federal government saying if there are no applications for a certificate of an Alaska gas transportation system within 18 months, certainly by the end of next year or February or March of 2006, the Secretary of Energy shall conduct a study of alternative approaches to the construction and operation. And I would say that you ought to be sure and have that in any fiscal package that you pass. You tie in with the federal law of anything you pass, you make that date very important, and I'll talk about that later of why the importance in a capital allocation decision. We want to get all these companies - producers, pipeline companies, to the true business evaluation phase, which crosses over the final detailed

engineering and cost estimates into the permitting phase and what have you, and then after all of that, which could take a couple years, only then do you make that decision at board rooms to start digging dirt and put a pipeline in the ground. Most projects go through these kinds of phases and to be approved, the project must pass all of those phases. It is important that the Alaska gas pipeline project has passed the preliminary evaluation phases to the degree that companies are interested enough in the producers that they have lobbied hard for the federal legislation and are working with the state. They are wanting to be able to lay something, I think, on the table to their boards that will get them to the business evaluation phase. And when you're in a company, and you're a manager-executive even of a profit center like in Alaska, you learn this kind of stuff. That's how the company works so you get a system of capital evaluation that becomes very cultural.

SENATOR ELTON asked Mr. Thompson where the corporations are on that list now and how working through the different steps will mesh with the 18-month timeline in the federal legislation.

MR. THOMPSON said in 1996, when he was president of Arco Alaska, he formed a permanent group to work the Alaska gas pipeline. [Prior to that] the three companies formed ad hoc project teams every three years to study the project for commercial potential and determined it was not a commercial venture. The teams were again created on a two-year basis and again determined the project was not commercial, the main reason being that a lot of re-injection was going on. By 1996, Arco Alaska was the first company to form a permanent team to determine what it would take to get the project done. The team was fully staffed and Arco Alaska brought in its best folks. He told members:

I would challenge the timetable it was in - so it's not just 18 months to make the decision about going to the evaluation phase, I'd say it's been 10 years. In 1996 we really began in-depth the preliminary evaluation phase with permanent staffing. Prior to that it was ad hoc team staffing. Does that make sense? So we were in the idea phase prior to then, in 1996 when ARCO crossed over to the preliminary evaluation phase, and I know ConocoPhillips has continued that work by having a permanent gas team, so it's been 10 years. So 18 more months to go to the business evaluation phase, but the only way to get them there is mitigating part of the risks that we'll talk about later and we know that mitigating the big chunk was federal legislation and now it's state fiscal certainty. That's the next big thing if we want to get them to the business evaluation phase, along with they want certainty in Canada as far as the regulations and they're trying to reduce costs as well.

So, I would hope, in 18 months, and I met with one of the undersecretaries of energy on this very matter a year ago, the federal government sees this gas now being needed for consumers, and if in 18 months there's not something laid out there, they are looking at alternatives. And I will tell you the alternatives they'll look at, and UBS and Lehman Brothers hit on it yesterday. They will look at somehow alternative financing and who isn't out there that wants to build this and get on with it?

SENATOR ELTON asked if the process is just short of a business evaluation.

MR. THOMPSON said that is correct and, in fact, producers may be saying they are in that phase now and could be. He explained, "I would venture certainly, in my mind, the business evaluation phase where I can start taking it to a board of directors is where now I've got a timetable to make a decision - 18 months, I have wonderful federal legislation and, hopefully, by next March or April and this next year, the fiscal package by the state is done and then you can take that and then more certainty in Canada and then you can get to that true business evaluation phase where after the couple of years of detailed engineering to get the cost honed in, as well as permitting, right-of-way procurement, you could then go to the board and you say this is a go-ahead or reject meeting."

REPRESENTATIVE CROFT noted that Mr. Thompson said that it didn't make any sense for ConocoPhillips to pursue the project earlier because it was making more money reinjecting the gas.

MR. THOMPSON clarified that decision included two main factors: gas prices were about \$2 to \$2.50 MCF but a constant \$3 MCF is necessary to get a 12 percent return; second, a lot of the gas was being

reinjecting into the oil realm and there was a very high oil rate. As time goes on, that very high incremental oil rate declines.

REPRESENTATIVE CROFT asked if that is one of the problems the state faces in confronting the internal capital management. He furthered that the state is not just dealing with the economics of the project but also with competing economics within the company.

MR. THOMPSON replied, "Sure. In that case, I will tell you my advice is you're better off having, at that time, that incremental oil. That incremental oil rate through gas injection declines and declines. By 2010 it may be diminimus and it's something that the companies look at. It's something the Oil and Gas Conservation Commission is surely looking at too."

REPRESENTATIVE GARA noted, in relation to Mr. Thompson's remark that companies have a finite amount of capital to spend, that ConocoPhillips just signed onto a joint venture deal in Russia and has "angles" on jumping from there into Iraq. He asked if the fact that ConocoPhillips has committed money elsewhere should be cause for concern for the Alaska project.

MR. THOMPSON said hopefully, ConocoPhillips will also try to balance this project at the right time and to its portfolio. However, ConocoPhillips is a D and P [Development and Production] company, as are Exxon Mobil and BP. He explained that those companies have to allocate a certain percentage in their portfolios. He pointed out that ARCO used to own a 5 percent share of LUKoil, which ConocoPhillips bought. LUKoil had set a deadline for its bid. He noted deadlines are non-discretionary in that if you don't meet the deadline, the opportunity is gone. He said as long as an opportunity is available, it is called "discretionary" and you may or may not have to allocate capital. He then stated:

Another reason they want that deal is that purely development and production. For Exxon Mobil, return on capital employed - you heard that return on capital employed for the pipeline being 12 percent, or return on equity, return on capital employed is a compilation of all this. Return on capital employed for Exxon Mobil in upstream development and production was 30.6 percent according to their annual report. Now you would put money into development and production? Or are you going to put it in a pipeline that makes 12 percent? The answer is you do want some in 12 percent, particularly if it's strategic in getting your products to market. And if you'll notice, and by the way, that average over there I took for the allocation last year, it's 2003, I took rough averages and then rounded up out of the Exxon Mobil and BP annual reports - you can get a breakdown of how they spent their capital. About 10 percent of their capital budget, total budget after they figured out how much to go to shareholders through dividends and then their other financing needs, they allocate big bucks worldwide and average 10 percent in exploration. Very risky, it's expense, high risk. You can hit and you can lose so you balance that. Development and production, that is their bread and butter.

You know, a shareholder wants to invest in these companies because they're in oil and gas development, not because they're pipeline companies. So they only allocate, and this is important to understand, they only allocated to pipelines and natural gas processing only about 10 percent. So when you're competing for the pie, it's not only you're having to compete for the total budget - maybe only 10 percent of their whole budget is getting allocated. Now if you take an Enbridge, a MidAmerican Energy, a TransCanada, I would suspect it's 80 percent or more that goes to pipelines because shareholders are buying them because they want that more constant kind of return, as well as that's what the business is they're in. Midstream is 10 percent. Downstream, oil refining and retail marketing was 20 percent and then chemical manufacturing. CFO, CEOs, boards will discuss what percent of the portfolio - it's sort of like an individual has to decide how much in bonds, how much in money markets, how much maybe in stock. These boards will decide how much in these phases of the business and last year for pipelines, natural gas processing, 10 percent of the capital for those lines of business.

What criteria [are] used? According to a survey done by the Harvard Business School last year of 700 major corporation CFOs, 70 percent of corporations make most of their decisions that you

get - you get it in the bucket - whether or not it gets done is a question, but at least to make it to the board table, internal rate of return is one of the criteria and then also discounted cash flow, net present value - if you look at all the cash flows in the future what's that worth today? And then payback period, especially if prices collapse. When prices collapse, and prices go low, companies look at payback period and only do things of short payback, for example. But my years at ARCO, at mini-corporations, certainly with Alaska Airlines, as well as Coeur D'Alene Mines Corporation, internal rate of return and discounted cash flow, net present value, are two of the most important criteria. And for those that want to learn more about this exciting topic, page 9 defines all those. Net present value, flow stream over 40 years, how much is it worth to me today? Internal rate of return is that rate of return on projects that you'd want to use and sometimes companies have hurdle rates rate of return. You just saw Enbridge talk about 12 to 15 percent, for example, and that's fairly common. Twelve percent is very common. In testimony Exxon gave a couple years ago to the state they said 15 percent rate of return.

Okay, let's have some fun now. Just quickly - here now you're the board of a corporation. I'm going to tell you you've had a phenomenal year because oil prices have been above \$40 a barrel - I should have put 50 but - and you have no capital constraint. You have so much cash flow that you have no capital constraint and you have three projects that you can do - A, B, and C. And these are all over the world. Summing up that column that says INV - that's investment on the project. The C1 is the cash flow that would come from it in the first year and you see the cash flow coming, positive cash flow in the five years. You can discount it at 12 percent and you get the net present value and then I showed you the investor's rates of return. You have unlimited capital constraint. Which projects would this board do? All of them. You have enough money. They all are above the 12 percent rate of return. They're all positive net present value. Uh-oh, here it comes, tough decision for the board. Here comes a brilliant young engineer in asking for projects that - there's three of them - engineer A, B, and C and they all argue. And what's interesting, they all lay out for you projects that are above the 12 percent rate of return - 21 percent, 14 percent. Only the oil prices have fallen to \$30 a barrel and you don't have \$130 million capital you can spend now. You can only spend 80. It's pretty much like our families. The family wants to spend more often than what you take in and you have to allocate, you have to budget. So this corporation, this board is going to budget, you only have \$80 million to spend and you have three very good projects. Which two would you do?

A key is, first look at the rate of return. If you look just at the rate of return, which two would you do? A and C. Sum up the net present value and see which two combinations yield the highest present value for the shareholders - are worth to the shareholders. [Indisc.] Again it's A and C. You add those two together and you get \$11 million [indisc.] for some of the big projects. Now which one doesn't get approved? B. Is it commercial? Yes, it is a very good project - 13 percent rate of return but it never makes the capital allocation. It is commercial. It is not competitive. That's the distinction and companies and shareholders demand that it be competitive.

Would 14 percent make - you have a couple of choices. You can defer that project to future years or what's another choice that sometimes an ARCO might use for certain projects? There are a lot of companies that would love to have a 14 percent return project that maybe have some capital. But you know what? If I can hold on to B forever, what am I going to do? I'll wait.

Another big factor in just the last point I made, boards also talk about is this a non-discretionary/discretionary. We often had to break down our capital requests into those two buckets and then it made it to the discussion on those kinds of criteria - discretionary, non-discretionary. I will tell you, I've got that clock from the prime ministers of Malaysia and Thailand. We had a deadline to get the field on-stream or lose and turn it over to somebody else to develop. Why did it make our capital allocation? Actually, it was a pretty good rate of return because of profit sharing and they took risk. So it wasn't a rate of return issue but we also knew that we faced a deadline and maybe it was 18 months. That's a good one that the federal government is saying, for example. This also matters - if it's discretionary, you can hold it and wait until it fits your

portfolio in the future or let someone else do it.

Now this is an interesting thing. This is a big decision. Let's get to [indisc.]. How does the gas pipeline project equity capital fit in the majors' capital portfolios? And if there's one thing we need to think about, is the way that you spread risk is taking a lot of partners. It's very common in industry. Does Exxon have to spend \$20 billion on this pipeline project? Is it a \$20 billion decision for them? Is it for TransCanada? No. Is it for BP? And you hear the words \$20 billion. It is not. It is not a \$20 billion decision for any of these companies. In fact if we look, they're going to put us at project - I'm wrong now, they did this before the federal government. They're going to project finance at 70 percent, \$14 billion debt. That's not wrong. We'll be able to have more because the 80 percent - and then equity capital - if you just took 70 percent financing, the capital needed is \$6 billion. Three big companies - how much capital do you have to lay out? Equity. From the capital allocation budgeting tool, how much capital do they really have to lay out? \$2 billion each - a lot of money. But the \$2 billion each is over 4 years of construction so it's basically on the - yea, if you look at it per year, and then this is the total capital spent last year by Exxon Mobil \$15 billion, BP spent 12.4, ConocoPhillips spent 6.2 and the equity capital needed for the line shows you how much each would spend and that would mean 3 percent, 4 percent, 8 percent of their capital budget.

But a big problem is - remember the other graph that shows you could fit this capital in but remember you only have 10 percent in your company allocated to midstream-downstream because you're not a pipeline company. People want you - investors and the stockholders want you to invest in oil and gas development and so that's an important thing to look at. By the way, another factor - look at the ROCE [Return on Capital Employed] that these companies actually made - 18 percent overall for Exxon Mobil last year. That's a composite of all the projects and assets deployed. Sixteen percent in the Phillips - 16. Does a 12 percent project excite those folks? No. In fact, 14 percent is pretty tough. It's time to share risk if we want this on their capital allocation.

Now has the debt worsened? This is interesting. This might explain some behavior. Here's the debt they would each take. All of them would have to have a debt. Divide the debt by three and this shows the debt each one would have to take. Now this is how much debt they have. This is amazing - \$9 billion debt, although Exxon has very little ratio of debt to equity. Now BP, ConocoPhillips has a little higher debt. In fact, if I was Jim Mahaney I might want an extra incentive or two. If I were Exxon, I wouldn't even care about the federal legislation. I might just write a check for my investment when the time comes.

So, you hear ExxonMobil not asking for incentives. They just want the federal government to pass the expedited permitting. BP wanted the other things but notice Exxon and BP don't want the commodity risk provision but ConocoPhillips does. I might too if I had a little higher debt ratio. I might want some extra assurance on downsides. On the other hand, this is still very safe. All of these companies - these are extremely good financial situations for all three of these.

Now though, a big home run for all of us was the federal government guaranteeing the debt. That debt you see there will not go on the balance sheets more than likely. They'll have to footnote it after the Enron fiasco but the debt will be owned by the pipeline company itself more than likely, and that has to be verified by the project financing terms. But these companies would report this debt in the footnotes of their financial statements and some investors would look at total debt that you see there, and a bit more of an impact on ConocoPhillips and Exxon Mobil, but still very, very financeable.

And then let me try to wrap up here in the next few minutes. You know, you don't just - when you go to the board - when I've presented big projects within Alaska to the board of directors of ARCO, I just didn't - we ran the projects at current oil and gas prices but we always had a sensitivity analysis after so many of us having lived through the down cycles of low prices. All of

our projects had to make a 12 percent return at a low side oil price. At that time we used \$12 a barrel. That's a sensitivity analysis. Most corporations do that. We do that at Alaska Airlines, Coeur D'Alene Mines Corporation - different sensitivity. The project had to be 12 percent at \$12 oil. BP's CEO, John Brown, in a speech to investor analysts in New York last April, mentioned that BP test all projects at a downside price now of \$20 a barrel. That's very common in many of the companies now, and many companies run gas projects with a downside of \$3.50 per MCF.

Remember when we did that example where we had to choose and we left out one project and we did two? You then run, if those are your two, you then run your whole company financials, if you made that your capital pot, what your corporation looked like and you looked at the effect upon cash flows, the company value, the debt equity mix in the future, and then the final portfolio is decided by executive management and the board of directors.

The CEO is the most leveraging single person in the decision with the board. When you have projects that are tough and you have to make some tough calls, that's very important. And it's not only the local folks of companies. I think they argue very hard for Alaska. It is the CEOs that can finally get this over to that phase that we need it to finally be decided.

You look at a lot of risk in the upstream-midstream projects. These are some of the risks. I think Ron did a great job describing pipeline risk and, you know, for upstream and midstream projects you have forecasting risk of production, the exploration-geologic risk, political risk, permitting, and what have you. Projects must be resilient to those risks. That's why when you heard the Governor and when you heard Pedro Van Meurs yesterday, whom I highly regard - now I don't agree with Pedro on one thing, that this capital level could make these people go bankrupt or put them into dire straights. \$20 billion for one company - he's right, but I don't agree with him on when you split it up among three or four companies and spread the risk that way, it is not as a percent of their capital spending each year a big risk. And a downside might be not a zero return, it might be if things collapsed, very high cost overruns and what have you, you could have impact but I would bet even then your return is 6 to 8 percent, not like with exploration. I've drilled several dry holes in my life. That's a pretty negative return. I had a few successes too. That's the only thing I disagree with him [about].

I do agree with him that risk mitigation now, if we want to get that project to get in the capital allocation of these companies that make 16 to 18 percent return on capital employed, then we have to take part of the risk and I think part of it is that equity ownership, and then consideration - I don't always know what's going on behind the scenes in the profit sharing, but it's something that needs to be considered. All the deals I did with other countries in my last two years at ARCO had those two factors. They participated in the equity and they had the profit sharing.

This is just an educational slide [18] for all of us. Commercial means this: the investor rate of return exceeds the cost of capital. I believe it was - I can't recall if it was UBS or if it was Lehman Brothers yesterday. You take a company that had to pay 7.5 percent on their debt, and then their shareholders are running at 12 percent return on their stock appreciation every year. The cost of capital would be 9.75 for that company when you weighted it. In most companies there's a premium that you put on that. So, an investor rate of return to be commercial for many companies here is 12, is commercial. Competitive? For an Exxon Mobil, for their upstream projects last year, their return on capital employed was 30.6 percent. They have some awesome projects. So, competitive, when you hear that, I believe the Alaska gas pipeline project today, especially after the federal legislation passed, is commercial today and no one would convince me that it's not commercial today. It does exceed the cost of capital on return. Is it competitive to get in the capital allocation portfolio? No. That's the distinction. Keep in mind that last point.

Corporations differ in IRR [Internal Rate of Return] hurdle rates. Return on capital employed of many pipeline companies is far less than producers and they allocate a larger percentage of their capital for pipelines and those kinds of companies might be very interested in 12 to 14 percent.

So here [are] the conclusions. [Slide 19] Getting the Alaska pipeline project into the major companies' portfolios is challenging. I believe the project may be commercial today, especially after the federal legislation, but it is not competitive. It is discretionary versus non-discretionary, although I do like the federal government's point of trying to nudge it and in visiting with the undersecretary of energy, trying to nudge a little bit of it to being non-discretionary within 18 months. It would be nice for the State of Alaska to do the same I think.

Investors who desire a commercial rate of return are important to consider as investment partners. I'll talk later about Pacific Star Energy. I will tell you this is our number one project. It is the only thing in our global portfolio and we would love to have a 12 percent return for Alaskans and our multiple partners can mitigate risk on any one firm. That's the way you spread risk. If somebody says this is too much capital to risk, get 10 players in. That's very common in exploration to have three or four instead of just one or two.

Government assurance of fiscal certainty is essential. I could not take this to the board - I had a slide each year when I presented in Santa Barbara in January to the board of directors. It was called political climate in Alaska and I would talk to political risk and what everybody was doing in the legislature and with the administration and what was the risk for the next outlook. I was fortunate that often the outlook was very positive, certainly for exploration and production and I think a lot of the things that you've done in the last few years has helped that segment of the business. Now it's time to address the fiscal certainty on the downstream side, midstream side of the gas pipeline. That's the next big thing. Canada has to do the same and I know the producers and pipeline companies are working on cost reductions.

Sharing of risk by government is essential. I will tell you I believe, and I'd recommend, you do the 12.5 percent. Now I will tell you in my own personal opinion, UBS yesterday gave an example of 25 percent. I wish they hadn't done that. I found it a bit confusing because the 12.5 percent - you already own the supply - your royalty gas, so that is not a risk for you. And then I believe you can find good customers and the state ought to be working on good customers right now. 25 percent though, you're going to have to make deals with producers on the supply and that could be a bit more riskier. 12.5 percent yes. The other you have to think about long and hard, not to rule out.

And then local ownership I'll talk about later in the second presentation. Local ownership does add incremental value. We have a report consultants say that shows for the first time quantitatively if profits off the gas pipeline are left here in Alaska, how many more jobs and how much incremental benefit it does to the economy and it's the first time it's ever been quantified to my knowledge as far as a private company owning part of the gas pipeline. It could mean an additional 20,000 jobs and \$1.3 billion to the economy over a period of time if you do that, and we'll talk about that later.

SENATOR ELTON asked if it is fair to say that it is more essential that the state take an equity position in the natural gas pipeline if the pipeline is producer owned, and less essential if the pipeline is owned by pipeline builders.

MR. THOMPSON said he would advise the state to take an equity position of at least 12.5 percent regardless of who owns the pipeline. He added that is based on his intuitive judgment, having seen country after country benefit by getting the profits of moving and selling their own gas. He indicated that the equity would amount to about \$50 million each year, which he would elaborate on later.

SENATOR ELTON asked, in the context of taking a shipper's risk, if it is less essential for the state to have equity ownership if a pipeline company is doing the pipeline.

MR. THOMPSON replied:

In either case, if I were the state when you had the equity ownership and then with your gas, I would also look at what could be customers on the other end of the pipeline that would be willing

to buy your gas, including we figure out all of the instate use. I'll talk about that more later in the second presentation, and that those firms are taking the shipping risk - the utilities that buy your gas are taking your shipping risk, as well as maybe firms within the State of Alaska that [are] buying Alaska gas could take the shipping risk. It may be, when you talk with customers that the state has to share in that shipping risk and you won't know until you go to the customers and the deals. But certain customers, even for pipeline companies you heard, will take that shipping risk and I think they will too for your share of royalty gas - for part of it anyway.

REPRESENTATIVE GATTO asked why everyone who speaks to the committee is encouraging the state to be an investor. He questioned whether the reason is that the speakers are charitable people and want to see the state do well or whether there is some inherent advantage to their positions.

MR. THOMPSON said he is saying that as an Alaskan advising the state on matters to consider. He said if one looks at whether the state should have invested in TAPS, the answer would have been no due to the cost overruns on construction but TAPS is the best operated pipeline in the world. He noted that a tariff of \$3 per barrel amounts to \$1 billion per year in revenue and the amount was \$2 billion during its heyday. He said members will see later the economic benefit if more of those profits are kept instate to be redeployed, versus the pipeline tariffs going to Houston or London. He then said he feels blessed to have worked in Alaska and then moved to other countries for his last two years with ARCO to see what the other countries have done to be highly successful in the natural gas industry. That experience motivated him to tell the state to do the same thing.

CO-CHAIR SAMUELS asked if it makes sense to separate the capacity from the investment in the pipeline itself and take a percentage of one and a percentage of another so that the state could be an investor in the construction of the pipeline but still only take the 12.5 percent royalty share in the capacity itself.

MR. THOMPSON said that financial calculations have to be made.

MR. THOMPSON indicated that making those decisions boils down to running the economic cases so it is hard to determine without seeing all of the numbers. He said hopefully Mr. Van Meurs and his team are doing that.

SENATOR FRENCH asked for some examples of places where collaborations between governments and pipeline owners did not work out.

MR. THOMPSON said he has seen some examples of collaborative exploration that were unsuccessful because you can lose everything. Some countries, because they want a stake in the production, will take the stake in exploration and lose when the holes are dry. He said the pipeline cases that he worked on were good for both the companies and the governments and did not require a lot of risk. He deferred to Mr. Van Meurs for a more detailed answer.

CO-CHAIR SAMUELS thanked Mr. Thompson for his presentation and asked Mr. Marushack to present to the committee.

REPRESENTATIVE BUD FATE interjected to thank Mr. Thompson who he has had lengthy discussions with. He urged members to partake of Mr. Thompson's knowledge of corporate inner workings.

MR. JOE MARUSHACK, Vice President of Gas Development for ConocoPhillips Alaska, informed members he would also be speaking on behalf of BP and Exxon Mobil. He noted he would be speaking on the ConocoPhillips decision-making process. He added that he would generalize about the decision-making process and then talk about Alaska gas in that context because Alaska gas is different and strategic. He would then make sure he answered all questions in the [September 27] letter. [Mr. Marushack's dialog accompanied his PowerPoint presentation. A copy can be found in the committee file.]

For major oil companies, projects, opportunities arise in many ways. There's outside proposals,

there's grassroots initiatives, there's management directives. Regardless of the size and the complexity of the projects, the initial approach to the evaluation follows the same path. However, the rigor with which you might go through the process could be very, very different.

All projects are evaluated in terms of their value drivers. The value drivers primarily are technical, commercial and political and, in the case of the Alaska gas pipeline, each of those are pretty extreme. Companies expect to earn returns commensurate with the project risks and the project risk in the Alaska pipeline is pretty significant. Models are created. Discount rates are assumed. We've got various ways of analyzing projects there that we'll talk about a little bit - discounted cash flow, Monte Carlo - basically Monte Carlo would be a form of probability analysis, decision analysis, and then that analysis goes into your corporate overlay where you're looking at the financial strength of your project, shareholder expectations - and you're going to hear me talk an awful lot about management judgment because, in my view, the Alaska gas project is an awful lot about management judgment.

The process we use in the key drivers - there [are] four or five major items there that you look at from a larger mega-project basis. Clearly [on] all projects we do analytical data and I'm going to talk to you about some of the analytical and metrics we do in a case there. The only difference between this project and other projects is the size of the models, if you will. The models on the Alaska gas projects are multi-megs. Some of them, a simple project could be a spreadsheet, some you just do over and over again.

Commercial arrangements - those can be hard or tough, not necessarily depending on the size of the project. A lot of times, the commercial arrangements are based on the relationships you've got in the country you're dealing with, as well as the prior history of that area. I would expect commercial arrangements on this project would be very significant - the financing issues very significant, a lot of detail analysis and a lot of detail arrangements.

Project management - Ken Thompson talked a little bit about that and I'm going to talk about it in a little different context because project management, once we get through the federal legislation and the state legislation and the state contract, this project is all going to be about project management and managing that - managing costs and managing risk.

The risk mitigation plans - what you've seen on the Alaska gas project are pretty much unprecedented risk mitigation plans. We've asked for several acts of Congress. We've been fortunate that we've achieved now, assuming the President signs, many of those. When it comes to the state, we've got the Stranded Gas Act application. These are pretty much unprecedented in the U.S. to need this kind of legislation and to be fortunate enough to be making progress on them.

And then alignment of the parties is important. Alignment of the parties - one of the things that - the question was asked a little bit about what does state ownership do? State ownership, in my view, the single biggest thing it does is it aligns the parties and we'll talk in more detail about that.

Once you add all that together, you bring in your unique analysis. You looked at this gated process we're going to talk about and your senior management input. I can tell you that on this project, senior management input happens every single month, every single week, sometimes every single day. This is a very, very important project to our senior managers.

Typical value drivers - what we're really concentrating on here is maximizing value. Revenue, expense, capital and schedule are the primary components of that. If you break that - the right-hand side are issues we're working on right now. The left-hand side are issues that we're trying to mitigate where we can, but basically we take what's left over from that. In terms of the revenue side, we're all price takers, not price makers and so the revenue will be what it is. Clearly we're looking at various scenarios but the revenue will be what it is.

On the expense side, once we get this project engineered we're going to know what the fixed and variable costs are fairly reasonably. And actually, what we're doing right now is working on taxes with the state. Those things though, you're left with after the project is up and running. The right-hand side is what we're concentrating on right now - capital and schedule. We're trying to control capital and, in terms of schedule, we're looking at the project management process in order to control that capital and put in there a timeframe that actually works.

You notice the value drivers here from the producer perspective, financing is not on that sheet. The way we look at the projects, we look at projects to try to get a fundamentally good project. Once we have a fundamentally good project, a viable project, then we figure out the optimum way of financing the project. Now we haven't completely discarded financing because we did draft the loan guarantee language. The loan guarantee language is actually something that helps after we've moved to those next steps, so it helps in the financing process but it's not a key value driver at this stage of the game from the producer perspective.

We think alignment with the state and the producers is something that really is addressed pretty well in the key drivers here. What we're really trying to do - we want the wellhead value to be as high as possible. We don't control the price so we are trying to control the cost. The costs of processing and transportation - that is essentially the capital costs of the project and how you're going to pay the capital costs of the project. Now why are the producers interested in this project from an upstream standpoint? Because those costs affect our upstream, our wellhead value. We're trying to control the costs, if you will. The whole project from some liquid hub up, in my view, is an upstream project and I understand why it's a big pipeline and a midstream asset and people talk about that but the project from Alberta north is an upstream project.

Talking about some of those tools, and this is just a very, very simplified measure of the tools that we use there, this is a decision tree analysis. A decision tree analysis can go out, page after page after page on the right-hand side, given all of the various things you're looking at but what we're trying to do here is we're looking at various scenarios. We're looking at you'll see P10, P90, P50 there. You might consider some of those to be price. We look at various price scenarios. You might consider some of them to be cost - P90, P10, P50 are costs. There might be reserves. There might be exploration. These things can go out a long, long ways. What I'm trying to show here though is what the decision tree does for you is it tells us where are the key items that we really need to concentrate on. What are the key risk elements that we've got out there? It does not give us a single answer. No place in here will we get a single magic bullet answer that tells us we're ready to move forward with the project. You've got to add together all the various issues, including the strategic implications to be able to move forward.

What measures do we use? We use the standard economic measures. We use after tax cash flow. We use discount rates. We use payout. We use profitability index. We use rates of return and we can describe what those items are and how they're calculated. The bottom line is no single one of them is magic. No single one of them counts necessarily more than any other one. A lot of times folks will ask us what are the numbers or the hurdle rates. First of all, there are no single numbers because risk for every project is different. Second of all, the strategic value of the project requires different numbers in different areas. Third of all, even though if there were some cutoffs, some general cutoffs, we don't share those things. We don't share them with Exxon Mobil. We don't share them with BP. We don't share them with the public. That would be a competitive disadvantage.

How do we communicate then how we're able to talk among others given when we don't share prices, we don't share discount rates? Well, we come up with a third party price forecast, if you will. We bring those into our model so we can speak on the same basis.

CO-CHAIR SAMUELS asked where the economic risk would fit in the decision matrix of a scenario in which ConocoPhillips might invest all of its money in a project in the Congo, which could then suddenly

nationalize the project afterward.

MR. MARUSHACK replied:

You try. We may have - when we go way out to the right-hand side here with various other elements, there we may consider the cost of - the probability of getting nationalized. We may consider the probability of new taxes. Clearly, in Alaska, we have to consider that because that's what our Stranded Gas Act negotiations are about. Let's agree on what the take is and let's agree on it for a long period of time. But it's not that simple, Representative Samuels, and actually this is where you get into management judgment and strategic value. Many times we'll develop contracts and those contracts will have lots of elements in order to protect ourselves. But we have experience with being nationalized. In the '70s we got nationalized in Venezuela. Now we're back in Venezuela. ConocoPhillips is probably the single biggest investor in Venezuela, based on relationships, based on opportunities, and based on risk reward. Obviously, if you're going into a country where you think you're nationalized, you're going to want to be rewarded for that and you're going to want to protect yourself as much as possible. It's also tied in with the relationship and the alignment issues and maybe this is one of the more important issues. A lot of times what we've done in order to protect ourselves is we do a deal in the foreign country on that asset, then we do a deal in the market, then we do a deal in the midstream, so we're all tied together. So nationalizing any one part affects the other parts here. Again, it's an alignment issue. You try to get yourself aligned. The more you can get aligned, the better off all the parties are.

CO-CHAIR SAMUELS announced that Senator Hoffman, Representative McGuire and Representative Berkowitz had joined the committee.

MR. MARUSHACK then said he would speak about the project management process:

This is part of a gated decision making process. The detailed project reviews include analysis and review of the project at all stages here and the stages change. The process is designed to mitigate risk and exposure to the corporation. This slide [8] that you've got right there is physically part of an internal project management process. It's ConocoPhillips' version. Again, Exxon Mobil and BP have similar processes although everyone calls their process a little different.

In stage one or the appraisal process, there is actually an area probably outside of this but we can consider all in the appraisal process. In that process, you're identifying and framing the concepts. You're evaluating those concepts. One of the things that ConocoPhillips did in this process is we didn't look just at the pipeline, we looked at GTL [gas-to-liquids] and we looked at LNG. LNG and GTL came off the table fairly - well I was going to say fairly quickly after about \$14 million that came off the table. We identified the pipeline project as having the best single opportunity out there. Then we got together with BP and Exxon Mobil. We formed a project team. We spent \$125 million on the appraisal process. What the appraisal process does to me is it tells me what I don't know. It tells me where my risks are so I can start mitigating risks. Out of that then you saw all the risk mitigation measures that we've implemented over the last three years since then.

The next two stages would be the optimize and define phases. Further refinement and project - it moves toward a single design. It occurs in these phases. Key commercial agreements are entered into, detailed cost estimates and plans. The work done in this stage should narrow the range of uncertainty to allow a final decision to be made on the project. For the gas project, this will take about \$1 billion in order to get through these next two phases. Now the reason I've broken up that bottom line you'll see into dashes, is because we will not commit \$1 billion, I don't believe. That's not normally how it works. We usually work in phases and so you'll commit some amount of dollars to do the first thing that you need to do to see how that affects the process. Then you'll go back and get some more money. Finally you'll be up through - but it will take you about \$1 billion, maybe more than \$1 billion to get to the stage of the AFE or authority for expenditure - the decision point.

Once you've got to that point there, then you're into the execute-and-operate position there. The

execute is where we'll spend somewhere between \$18 billion, \$19 billion. If you don't have to go from Canada south, you'll spend something like \$15 billion. A key element on here is a natural tension that we see between those of us who have to implement this and those who want to see the project move faster and faster. This must be a very disciplined process. Where you see projects get off track and you go back and you do analysis of what happened is they took shortcuts on their project management process. When you take shortcuts on your project management process, you're clearly going to have cost overruns.

The next slide [9] hopefully gives a summary view of how that happens. During concept and feasibility phase, those are the stages where we have the ability to make material changes - material design changes, consider the risk opportunities and how to mitigate those. The cost of doing those is fairly low. We've spent \$125 million, not \$1 billion. As you're moving into design and execute though, every stage you move into, the cost of making changes gets higher and the opportunity to influence how you make those changes is less. Finally, when you're in the execute stage, if you've found that you short-circuited the process and you've got train wrecks that should have been picked up in either concept or feasibility, you can't change all that much and the cost of change is very, very expensive. An example might be TAPS. Through the execute phase, you saw the project go from what - \$1 billion to \$8 billion, \$9 billion - something like that, and the problem with that is not everything was done in order on concept, feasibility phases of analysis.

In terms of the critical elements - we've completed a \$125 million study. The study concluded the project was technically feasible but had significant risks. We identified where governments could play roles and we've been working to address those risks. Where we're at on this right now is the State of Alaska fiscal certainty right at the very top. That has to get done in order to move forward. That's the single most important issue out there right now and it's also one that between the producers, the administration and the legislature, we control that process.

We've got passage of the federal legislation - very, very positive series of events there. The predictable Canadian regulatory process - we're not saying we need new laws. We're not saying we need new regulations but we do, as we're getting progress on the first two items, need a process to make sure about how the regulatory process in Canada will work, how it will work with aboriginals - and a long-term favorable market outlook.

This project - one of the questions you asked is what gets shared with your board. I'm going to go back through all those questions here in a minute here. This was actually something that's been shared with our senior management and our chairman. I don't know if it made it to the board or not but I suspect it did. What this tells us right here, this project is absolutely unique. It's not like anything else we've ever done. I think Pedro may have mentioned that this is the biggest project in our portfolio - I believe he said that - clearly for ConocoPhillips. He's exactly right. When we've been doing planning, when we've been doing logistics, there are no models that cover a project as big as this. Hence you go back to the project management process and you really have to have that well understood.

One of the key elements that we've talked about is this assessed timeline on here. This was included in our application but I thought it was important to talk about where we're at, where we're going. Right now we're working on government frameworks. We had a big success this week. We're making, I feel, progress with the state. I think the things you've heard from the Governor and Pedro yesterday were very positive. A key element, again, on that government framework is the fiscal contract.

As we move to the next stages, the next stages would be to begin environmental work for the FERC/NEB application, detailed technical work to be completed, so that those committees of an open season have sufficient assurance that the project design, cost estimates are accurate so that they can make binding precedent agreements. We hold an open season. If sufficient gas is committed, we finalize the design on whatever gas has been committed and at that point in time,

then we're looking at trying to define the right-of-way and finalize that.

Finally, we get to a record decision after we get all permits back. Once you're in the record of decision, then you're starting to spend very, very significant dollars on procurement and on construction.

Procurement and construction will take - what we're talking about is, again, pretty much unprecedented. GE [indisc.] compressors are the largest compressors on earth. Those are actually backlogged compressors right now. Steel that's 48 or 52 inch, inch and a half thick, X-80, X-100, not rolled right now in any place in the world. Clearly we need 40 percent of the ability of the world to make that over a very long period of time. So when folks talk about trying to streamline or fast track this process, we've got a lot of people - a lot of people who've done big projects think this is a pretty aggressive schedule. In fact, if you had one of the engineers here talking to you rather than the commercial people, you'd have a little different spin on how aggressive this was.

We think first gas about 9 or 10 years after we're into project planning is very aggressive and we're pretty excited. It's a good opportunity.

Before I conclude, I wanted to go back through what, Representative Samuels, the letter you sent us and make sure I at least made an attempt to answer all the questions. Frequency of decision-making and whether annual or otherwise? We do annual budgets. Our budgets are approved on an annual basis. Major projects and major opportunities are reviewed on a quarterly, monthly basis. On this project, we get a lot of input on this on a very, very regular basis. We're not talking, I don't believe, in this project when we go to the board of saying commit \$20 billion or \$6 billion or whatever the number is. We're talking about a phased approach. Clearly what we would do is we would lay out an approximate timeline with approximate costs in it and get that approved but we're only approving this on a phased basis.

Percentage of equity and debt assumed for purposes of comparing costs of projects? We assume all projects must pass the hurdle rates if we're putting 100 percent of our own money into it - 100 percent equity. Actually, a capital budget is an equity budget. How you finance out of that capital budget is then a separate series of issues. Clearly on this project once we move forward into these phases where you're investing serious money, billions and billions of dollars, we'll be looking at how to finance that, we'll be looking at how the federal loan guarantees work. The federal loan guarantees, though, are not a panacea because you still have to work through either the project or the corporations. What the federal loan guarantees really did - going out and trying to get \$16 billion in capital is, again, unprecedented. We thought the loan guarantee there would help make going out and getting the financing a little bit easier and we hope through the loan guarantee we also could get a little reduction in the interest rate that you pay because you have the federal government way behind all of the project there, which may reduce the toll a little bit also.

Net present value rate of return, hurdle rates - I think I've discussed them. Limitations on available capital? Again, this project is really, really different in that regard. This project is a strategic project. When you hear Phillips' executives talk about this project, you hear them talk about Alaska as a legacy project, a legacy asset. Including the Alaska gas project for us is our biggest opportunity. It has the ability to book substantial reserves. This is being reviewed as a project that needs to get funded in the capital - when we've got the risk and reward balanced right.

P50, P90 sensitivities - we've talked about those a little bit. Risk of the pipeline project versus exploration - I'm not exactly sure what was meant here. Exploration is a whole different concept in my view where you know that the money you're risking has a very high probability of zero return so that's built into your corporate portfolio. The Alaska gas project is very different. You're not

going to invest \$6 billion, \$20 billion on a gross basis unless you think that this is a project that makes sense for you.

Diversifiable risk versus non-diversifiable risk - again, I assume this is a question that is - are the oil companies in the business of taking risk or not? We're in the business of taking prudent risk and so a lot of what we've done is trying to address how we limit that risk and how we minimize the risk and make this a good project for our shareholders.

Factoring the consequences of failure to invest? Again, this may be code for reserves tax and I'll assume it is because by adding additional costs or burdens to the project does nothing to improve the viability of the project.

Imposing a gas reserve tax sends a strong negative message to the same folks that we're trying to get to make a strong strategic decision to invest up here. It increases the perception of project risk and it really moves my team for how to get this project done into how to fight off a reserves tax that we don't think is justified so it takes time and sets back the project.

Ranking potential projects? Clearly there's ranking of potential projects. Alaska and the Alaska gas project is very, very different. When you see companies do these big strategic deals - LUKoil, things like that, sometimes they're in the budget, sometimes they're not in the budget. They're strategic decisions though that aren't probably part of the normal way that you allocate capital and I would view the Alaska gas project as having many of those characteristics.

Materials available to and in the role of management committee and board of directors? Our chairman is our decision board on this project. He knows an awful lot about this project. He's very interested in this project. He will, as I think as Ken Thompson said, be highly influential about what goes to the board and what the board approves. I feel pretty good that through a process like this you get to know your decision makers pretty easy, you know what they're looking for. Clearly it's my job to take him all the information - take them the decision trees, the political aspects. It's his job then to say have I got the risk and reward balance right and make the call on the money.

So, in conclusion...

CO-CHAIR SAMUELS interjected to say the consequence question wasn't just aimed at the reserves tax, it was also aimed at what happens if the window of opportunity closes for Alaska as the market shifts to LNG or an entirely new source.

MR. MARUSHACK said he does not actually believe in the window of opportunity. He believes in making all projects as economically feasible as possible and moving forward to fund them. He stated:

We want to do every economic project to increase the shareholder value that we possibly can. Now in terms of gas, do I worry that the price of gas is going to get too high and you're going to get fuel switching? Yea, I think that's a legitimate issue. Do I think LNG is going to ever close the market so that there will never be room for Alaska gas? I don't believe that at all. I think LNG has finite permitting problems - I mean we're seeing that on projects we're trying to do. I think you need a diversified source of U.S. energy. I think Alaska gas is a very positive. I think it is something that people are going to want to see and it's just a question of if the market is going to support that or not. The way I tend to look at this is I want to bring these projects on as quickly as possible. I do not have any fear of competing with LNG projects. I do have a little more fear of too high a price.

MR. MARUSHACK then continued his presentation.

Okay, in conclusion, I just wanted to reiterate here - very large project, largest infrastructure project that we can find, no models that really work in this case, no logistics models, you know, we're kind of looking at military models. That's about the only thing big enough to make any sense to us. Size of scale creates a lot of risk, a lot of risk when you're talking about the amount of dollars here. There's no single metric approach or criteria. We use a discipline process

designed to reduce our risk. Lots of gates - when we're spending money, that's a positive case. Folks always want to know when do you commit the \$20 billion. Actually, in no project do we commit to full funding until we're actually starting to buy steel and drill or whatever it would be. We want to avoid artificial deadlines that increase cost and risk. For the priorities, we'll try to develop a strong base project, follow a disciplined project management process, get our deal done with the State of Alaska so we can move on to the next phases.

Representative Samuels, with that I'm here to answer any questions that you may have.

CO-CHAIR SAMUELS informed members that he and Mr. Marushack have discussed proprietary information, which no one wants to give out and the difficulty of attempting to speak for three companies. He thanked Mr. Marushack for providing generic answers to questions, as that is what he asked for.

REPRESENTATIVE GARA asked Mr. Marushack to address the timeline he mentioned of 2014 as the date gas could be on line. He also asked Mr. Marushack where he stands as far as seeing the project as financially feasible and, if he sees the project as feasible, how soon he thinks gas can be on-line and whether the state's goal of getting that gas to market in 2012 can be met.

MR. MARUSHACK said, regarding getting gas on-line by 2012, ConocoPhillips and BP have operating experience on the North Slope. All three companies have a long history of investing and working on very big projects. He said he would like to bring the project on in 2012 too but when ConocoPhillips laid out the plan, it saw 2014 as the best possible case. He said fast tracking has safety and environmental implications and this project is too big to take any such risks. Regarding the tax mechanism and financial feasibility, he said ConocoPhillips and BP looked at how to make this project go forward and recognized that federal mechanisms were needed. Together with Exxon, the three companies developed enabling legislation. The companies still believe the tax mechanism is very important but they will continue to work on that in Washington, D.C. while it is negotiating with the state. When they complete negotiations with the state, they will look at where they are at on the federal side, look at the market, and then reassess and decide whether to move forward with the project.

REPRESENTATIVE GARA asked if he would be working on the \$2 low price guarantee at the same time he works with the state. And then, assuming that he doesn't get the low price guarantee, he'll see what he gets from the state and then decide whether he still needs the low price guarantee.

MR. MARUSHACK said he would call it a tax credit, not a low price guarantee. He explained that a tax credit has not been included in any federal legislation but he believes it still has some value. He plans to work with the state to get a deal done and then look at the state deal, any federal legislation at that time, the market, technical feasibility of the market, and decide how to move forward with the project. He said if prices drop substantially, that would be an important component. He assured members that he is willing to move forward as rapidly as possible to get the state deal done so that he can begin to move into the next phases.

REPRESENTATIVE CROFT asked if ConocoPhillips would commit to build the line if it got the federal tax credit.

MR. MARUSHACK noted that ConocoPhillips has said in the past that if the legislation out there was enacted and it had a deal with the state, it could move to the next step. He said the next step is investing the \$1 billion to see if the project is feasible. Right now, ConocoPhillips believes it has a \$20 billion project. If, after the design engineering, the project cost is \$40 billion, the state and ConocoPhillips have a serious problem. Therefore ConocoPhillips will invest a substantial amount of money to move forward if it has the pieces.

SENATOR ELTON said he first heard about the 18 month provision in the federal legislation that morning and asked how that will affect the decision making process and the magnitude of the issues that need to be addressed.

MR. MARUSHACK said it does not affect him because ConocoPhillips and the producers want to get a deal done with the state as quickly as possible so that it can go before the legislature this session. He noted the reasons are high prices, the state wants the project, the producers want it, and the timing is right. He repeated the 18-month window is not as important to him because now that the federal legislation was enacted, he wants to get the deal done with the state as soon as possible.