Stranded Gas Hearings
(0406160910 Minutes)

The Impact of Tariffs on In-State Exploration Activities
Mark Hanley, Manager, Public Affairs for Alaska, Anadarko, June 16, 2004.

MARK HANLEY, Public Affairs Manager, Anadarko Petroleum Corporation, said that he would provide the committees with an explorer's perspective. This would be an explorer who hasn't discovered gas already, but does have significant acreage positions in gas prone areas. Mr. Hanley pointed out that what he's heard thus far is that every entity wants to do the best for its shareholders, although there are different motivations. Therefore, the state needs to understand those motivations, how they fit together, and whether they are fair or not. Decisions on the aforementioned will determine whether companies such as Anadarko explore for gas or not. As has been indicated, the rules in this game are fairly flexible. For example, earlier Mr. Myers stated that pipeline tariffs don't necessarily represent the actual and reasonable cost of pipeline transportation, which is of concern for an explorer. An explorer would want the lowest rate possible in order to generate the highest wellhead, which provides the most economic ability to explore and make the most money. In general that would be true for the state as well. However, if the tariffs don't represent the actual and reasonable cost, he doubted they would represent [less than] the actual cost. He assumed that the assumption is that the tariffs would be higher than the actual and reasonable cost. Therefore, the explorer's position would be negatively effected. Furthermore, the rates can't be unduly discriminatory, which he surmised to mean that they can be duly discriminatory. Moreover, there can be the "black box" methodology in which the rates are known, but whether those rates are fair or not isn't known. The aforementioned is a difficult situation.

MR. HANLEY turned to the question of who makes the decisions on how these things are set up and said that it depends. Sometimes the pipeline owners set up things in the tariffs, and other times it can be FERC as part of the regulatory process, or even the state can specify that charges aren't reasonable for royalty purposes. In fact, "they" may be able to obtain a lower transportation rate. Mr. Hanley reiterated that the rules of the game are very fluid and there is much ability to change those rules. Therefore, explorers are going to sit back and watch.

MR. HANLEY stated, "If there's no gas pipeline, there's no exploration." He acknowledged that people say there is a lot of gas out there, and perhaps [Anadarko] could build the pipeline. However, Mr. Hanley pointed out that 35 trillion cubic feet (tcf) of discovered gas that is already being produced and for which there is no exploration risk "and it's challenged getting this pipeline going." The odds of someone being able to find another 30 tcf of gas to justify this pipeline is next to nil. Therefore, it is likely that explorers aren't going to be able to find enough gas nor would they invest the billions of dollars to do so. Mr. Hanley related that Anadarko is very supportive of building a gas pipeline. However, the rate for explorers needs to be as low as possible, which he believes to be true for producers as well. As in the case of oil, the farther away one is from infrastructure, the larger the field needs to be. With a lower tariff, there will be smaller fields that are economic and create the chance of obtaining more revenue. Therefore, generally it's in everyone's interest to have the rate be as low as possible.

MR. HANLEY turned to the issue of reasonable access terms and conditions. He pointed out that the Foothills area tends to be more gas prone and not as liquid prone. Although it's known that it's a gas prone area, it isn't known if it's commercial because that wasn't tested. Mr. Hanley informed the committee that a couple of years ago Northern Economics did a study for Anadarko with regard to commercial gas development in the Foothills area. The study goes through the 30-year life of a gas product in the Foothills area.

MR. HANLEY informed the committees that in Prudhoe Bay alone there is 35 tcf of gas while the estimate for the remainder of the North Slope is somewhere between 70-80 tcf of undiscovered gas potential. In the Arctic National Wildlife Refuge (ANWR) area and Foothills area, there are [gas] estimates of 8.5-9 tcf. There is a lot of potential for gas and exploration. With all that, one might question why a gas line hasn't been built. However, typically the largest risk in exploration is the geological site, the underground side.

The [risk surrounds] whether gas will be found; whether there is enough gas to flow in quantities; and whether the gas will be close enough to infrastructure to make a commercial gas find. However, the largest risk in Alaska is the aboveground risk, the commercial risk, [which includes] the risk of the tariff being too high, construction cost overruns, legal challenges, permitting, and price risk. The aforementioned are fairly significant risks, but the state can come in with fiscal security.

MR. HANLEY addressed the difference between explorers and producers, which he explained through an example of how capacity on a pipeline is acquired. This pipeline will be a contract carrier rather than a common carrier. Mr. Hanley emphasized that pipeline ownership has no bearing on capacity ownership. Capacity is allocated during an open season. Typically, the pipeline owners will set the terms, the tariff, and express interest. Then an entity can sign up for capacity, which is typically a 20-year contract. The entity would be committed to pay for that capacity regardless of whether any gas moves down the pipeline. Although the aforementioned is a risk, the benefit is that the capacity is owned by the purchasing entity and no one can pro-rate that entity out of that capacity. This is important because explorers are unlikely to explore for gas before there is some progress indicating that a pipeline will happen. If the pipeline moved forward tomorrow, the open season would likely happen in a couple of years. However, it takes 3-5 years for explorers to determine whether they have a commercial gas find, which means that all of the existing capacity is likely to be taken by the existing gas holders because they have the gas and once the terms are known, they can nominate capacity. Mr. Hanley specified that the expansion tariff rate and the terms and conditions of the expansion of the pipe are probably most important for explorers. He informed the committee that the design of the pipe and how it's set up can determine the expansion rates. Typically, expansion of a gas line means adding compression rather than the pipe getting larger or adding new pipe. Furthermore, the design of the pipe can determine the terms and conditions as well as the rates of any expansion. Just adding the compression could result in initial expansions that should have a tariff rate that would be lower than the initial tariff. If the gas line is designed [to allow for expansion], explorers will have some idea that the expansion will be no more than the existing tariff and will probably be a little less than the existing tariff. However, he noted that pipelines can be designed so that every expansion is more expensive, which is of concern for the explorers.

MR. HANLEY mentioned that tariff terms are as important as tariff rates. He recalled discussion with regard to a BTU tariff versus a mcf. He explained that if [there was a change to a mcf tariff] without having a quality adjustment, one could find, on a volume basis, that the liquid heavy oils with a higher BTU content actually do better. Therefore, [the explorers] could end up at a competitive disadvantage if the tariff is set a certain way. With regard to expansion, the terms and conditions can be set such that initial pipeline owners maintain a right of first refusal on all expansion capacity. The aforementioned can stymie a competitor who would have to approach a competitor that has the right of first refusal on all the expansion capacity. If such conditions are included in the tariff, it is of concern. Mr. Hanley related [Anadarko's] view that FERC doesn't have the ability to force the expansion of a pipeline, which is concerning in a situation in which the pipeline is owned by the producers who are competitors of the [explorers].

MR. HANLEY clarified that [Anadarko/explorers] want the lowest tariff possible and typically would prefer a flat line [a levelized tariff] as presented by Mr. Myers because a number [of explorers] already have exploration acres. A higher tariff in the beginning could mean that [Anadarko and other explorers] couldn't explore for that gas. Furthermore, it's a bit more costly in the Foothills. He related that Anadarko would incur costs as far as development and exploration that don't exist at Prudhoe Bay because the gas has already been discovered. Because of the aforementioned [Anadarko and other explorers] will be as challenged, if not more challenged than others. Mr. Hanley turned to the proposal of 4.5 bcf a day pipe, and pointed out that a penny a day would mean $45,000 a day or $16.5 million a year. Twenty cents, which may be 10 percent of the $2 tariff, can result in as much as $330 million a year. Therefore, pennies on the dollar make big differences on the netbacks.

MR. HANLEY informed the committees that there is a normal incentive to have a low tariff with a high netback. However, if it's a producer-owned pipe and the producers are aligned, there may be some incentive to shift as much profit as possible to the pipeline. There may be a producer interested in

obtaining a much higher rate of return on the pipe because the producer would obtain the profit from that while reducing the wellhead value, which results in a double benefit. Reduction in the wellhead value results in the pipeline owner paying less in severance taxes and property taxes. Mr. Hanley noted that explorers have a varied interest. However, generally speaking the explorers want the lowest rate possible and want a pipeline built. In fact, often the explorers are aligned with the state's interest in trying to obtain the most revenue and the highest wellhead value. Many times the explorers are aligned with the producers, and sometimes the explorers are aligned with the pipeline owner. Typically a pipeline owner that isn't a producer isn't necessarily concerned with controlling capacity and in fact, expanding the pipe and lowering the operating cost is beneficial to them as well. Therefore, a pipeline owner that isn't a producer may be more interested in expanding the pipe sooner than a producer-owned company that may want to utilize the pipe to control capacity, which allows control of exploration. Mr. Hanley reiterated that the explorers want a pipeline to be built, the lowest possible rate, and fair and reasonable terms. He concluded by highlighting that [the explorers] believe exploration is good as is competition, and furthermore the more gas that is put in sooner will result in more people involved in the pipeline, which should lower the cost.

SENATOR OGAN inquired as to who would be the operating partner in the areas labeled "Anadarko Partial" shown on the map provided to the committees.

MR. HANLEY answered that in some areas Anadarko would be the operating partner and in other areas it would be ConocoPhillips Alaska, Inc. Generally speaking, in Alpine and to the west in the NPR-A [National Petroleum Reserve-Alaska] area, Anadarko has interests with ConocoPhillips, which is the operator. In the Foothills region, Anadarko has state acres and ASRC [Arctic Slope Regional Corporation] acres in which Anadarko is the operator.

SENATOR OGAN highlighted that currently Alaska Oil and Gas Conservation Commission (AOGCC) has the authority to regulate the waste of hydrocarbon. Senator Ogan opined that the state has an interest in which gas is produced first because a company that owns gas in the Prudhoe Bay unit would want to sell that gas. However, it seems to be in the state's advantage to place gas that doesn't interfere with oil production in the line first because it would mitigate the decline of revenues from the oil. He inquired as to Mr. Hanley's thoughts on the aforementioned.

MR. HANLEY suggested that a model would need to be run. He said he would want to support putting in the Foothills gas first because that's where Anadarko has an acreage position. However, the state should review it because Mr. Myers indicated that the state might receive a bit lower netback on [the Prudhoe Bay unit] gas. He noted that even with a model, there would be some policy calls. Mr. Hanley mentioned that the ability to get gas in that pipeline is going to improve oil exploration economics because when one explores for oil on the North Slope one often finds gas.