

Alaska Gas Development Project

Non-Recourse Bonds, Federal Loan Guarantees, and Innovative Financing by Host Governments

October 13, 2004

Lehman Brothers Representatives:

Philip Korot (212) 526-4842

Robert Milius (212) 526-2664

Almin Hodzic (212) 526-4245

LEHMAN BROTHERS

Introduction

Mr. Chairman and Members of the Committee:

Our names are Philip Korot, Robert Milius and Almin Hodzic and we are pleased to submit this testimony on behalf of Lehman Brothers regarding the commercialization of North Slope natural gas through the development of a transportation infrastructure to move the gas to the Lower 48 states or other markets in which it is needed. Founded in 1850, Lehman Brothers has long been one of the premier firms on Wall Street. We have approximately 14,636 employees in 75 offices worldwide, including fifty-two in North America, seven in Asia, three in Latin America and thirteen in Europe and the Middle East. Lehman Brothers serves the financial needs of institutions, corporations and governments in all major financial centers worldwide. We are a member of all major securities and commodities exchanges around the world. Lehman Brothers acts as a market-maker in all major fixed income and equity products and in certain commodity and derivative products in both the domestic and foreign markets.

Our Global Natural Resources Group leads Wall Street investment banks in advising clients in the energy sector. Our client base reflects all major segments of the energy value chain, from exploration to midstream and pipelines and from refining to marketing. Lehman Brothers' Global Natural Resources Group provides a comprehensive array of investment banking services to energy clients – including strategic advisory, equity and debt underwriting, project finance, trading and commodities/derivatives. Since 2003, Lehman Brothers has been the #1 underwriter of U.S. energy equity new issuance, acting as book-runner on 39 transactions worth over \$5.9 billion. Over that same period, we have been the #1 underwriter of U.S. investment grade energy debt, acting as book-runner on 20 transactions with total proceeds of \$9.4 billion. Year to date in 2004, we have raised a total of \$3.2 billion in equity and \$6.2 billion in debt on behalf of companies in our sector.

Lehman Brothers has extensive worldwide experience in structuring and financing complex projects such as the Alaska Natural Gas Pipeline. Having managed more than \$27 billion of project finance bonds since 1998, Lehman Brothers has been named “Bond House of the Year” by *Project Finance International* in 3 out of the last 5 years.

Finally, Lehman Brothers has a long and consistent record of supporting the State of Alaska. We have been underwriting bonds in the State since the 1960s; we served as financial advisor for the Alaska Municipal Bond Bank from its inception in 1976 to 1994; we helped resolve the Four Dam Pool problems in the late 1970's and early 1980's; and we have performed countless other services to the State and local governmental issuers since even before statehood. Lehman Brothers is the leading underwriter of Alaska municipal debt, having senior managed nearly \$4.963 billion of financings for 25 different Alaska issuers since 1960. We are one of the lead underwriters for Alaska Housing Finance Corporation.

General Observations on the Capital Markets

We have been invited to speak about financing alternatives available to Alaska's proposed natural gas development projects. We thought it would be helpful to begin with some general observations about the capital markets as they apply to this project.

Lehman Brothers in general and our Global Natural Resources Group in particular have been extremely active over the last two years. The ongoing economic turnaround has been accompanied by substantial growth in the issuance of securities for the financing of companies' capital projects, balance sheet restructurings and corporate mergers and acquisitions. We have been party to the significant strengthening of the debt and equity markets and in general we can say that the capital markets are accessible on all fronts, both debt and equity.

The energy sector has been exceptionally strong and has delivered superior returns to both equity and debt investors. With commodity prices for all energy products at all-time highs, and with the market increasingly viewing this new environment as sustainable, everyone from Alan Greenspan to the residential utility customer or gasoline buyer has become acutely aware of the growing tension in the supply and demand balance in the nation's markets for oil, natural gas and coal. Oil has recently moved above \$50 per barrel for the first time ever and many analysts and energy companies have raised their long-term price expectations significantly. The forward strip for the next four years is in the \$35 - \$40 range. The changes in natural gas prices have been equally dramatic, with forward gas prices now in the \$5 - \$6 range for the foreseeable future. Industry and Wall Street experts are increasingly in agreement that the energy markets have undergone a fundamental change based primarily on the ever-increasing challenges of finding and bringing new supplies to market.

The fixed income markets have also been exceptionally strong over the past two years, delivering solid returns to investors and favorable financing rates to issuers. At a high level, both the commercial bank market and the corporate bond market have witnessed Treasury rates that are currently near historical lows, and credit spreads that are at their tightest levels since 1997. Liquidity in the fixed income markets has been excellent, allowing issuers to refinance outstanding debt at more attractive levels as well as borrow new debt to finance organic growth and/or acquisitions. Over the course of this year, the three key themes in the fixed income markets have been: slow and steady economic growth, moderate new issuance of corporate debt, and strong investor demand both from U.S. and international investors. As we look ahead, we expect these trends will continue for the foreseeable future.

Focusing in on the energy sector of the fixed income capital markets, the unprecedented strength in commodity prices has created a supply-demand dynamic that benefits issuers of fixed income securities. Investors are seeking to increase their exposure to the sector due to strong fundamentals, which investors believe will persist for some time. At the same time, the net new issuance of securities has declined recently – as companies have had less need to rely on external financings for ongoing capital expenditures or new projects. As a result, companies have in fact been repurchasing significant amounts of their outstanding debt and equity in the marketplace as a way to deploy their excess cash flow.

Against the background of these solid market fundamentals, the project we are discussing would find particular appeal. The United States confronts an ever-growing structural deficit in its natural gas markets. U.S. natural gas supply has declined 8% in the last five years, and it is anticipated that imports will contribute an increasing proportion of U.S. supply in the future. We mention this not to repeat a theme that is already well known amongst this group, but rather to point out that this is a theme that is increasingly well understood among institutional and retail investors in the capital markets. A project to commercialize North Slope gas will, in our view, be

extremely well received by Wall Street and institutional investors. The “story” is compelling, due largely to limited new natural gas coming on line in the United States, coupled with the renewed focus on national energy security in the post-9/11 world.

Lastly, we want to note that we believe all three potential development strategies – the All-Alaska LNG strategy or either of the two pipeline routes – could be financeable. We believe that at a high level, the broad capital markets will be “route-neutral.” The “story” that investors are buying is that a tremendous stranded gas resource is being commercialized and that this development in turn is part of a strategy to address the energy security concerns facing the United States today. We clearly understand that much work needs to be done to determine which route makes most sense – technically, environmentally and economically. But once the decision has been made and a route and strategy have been selected and permitted – and a viable commercial structure has been agreed to – the capital markets will be interested in the story regardless of the specifics of the particular route.

In summary, investors’ appetite for energy investments like this project is strong. The financial community increasingly understands the complexities of the natural gas market and will be comfortable putting money behind large new projects. Perhaps most importantly, we expect that these conditions will persist.

Critical Parties and Roles in Project Structure

Bringing natural gas from the North Slope to the Lower 48 requires an enormous amount of coordination between stakeholders. In designing and structuring a complex project such as this, literally millions of decisions must be made to determine how participants will interact, who will take which risks and who will receive which rewards. Each decision will impact the feasibility of the physical project, the viability of the economics and the financeability of the entire system. What we would like to do is discuss the handful of key issues that will fundamentally determine the financeability of the project in the capital markets by driving credit ratings, ownership structure and the marketability of the project to institutional and retail investors. The State and Federal governments have important roles in this process and we believe that identifying their appropriate roles depends on understanding the interactions between the government and commercial institutions. With the right degree of involvement, the government can help promote an optimal outcome. A wide variety of alternatives are available, and we will highlight some of the key options’ merits and considerations.

We will start by describing the general way in which the capital markets think about this kind of investment and what features need to be in place to make it work. The items that matter the most to the capital markets revolve around commercial structure, ownership and the risk and reward allocation. Then we will discuss more specifically the type of financing options and the risks and rewards associated with this project. Finally, we will explain how the State and Federal governments can play a role to help expedite and optimize the outcome.

Sharing of Risk

In structuring any commercial project, financial investors seek to manage the sharing of risks and rewards. In this case, there are many stakeholders with varying levels of understanding of the many types of risk involved. Ultimately, someone must bear each risk, and in this case the list of risks is understandably lengthy: market risk, political risk, resource risk, construction risk, operational risk, terrorism and catastrophic risk, to name a few. Investors will want to isolate and identify their exposure. Investors in the capital markets are willing to take certain risks, whereas

strategic participants such as producers and offtakers of gas understand and may be willing to assume other risks that purely financial investors will avoid.

The project we are discussing faces two primary categories of fundamental risk: short term project completion risk and long term natural gas market price risk. Completion risk includes anything that could delay the commercial start-up of the project temporarily or indefinitely, such as permitting delays, cost overruns, technology issues, sighting disputes, material shortages or weather. In general, these risks are difficult to predict, hard to quantify and therefore difficult to insure against or evaluate in the financial markets. Completion risk is entirely limited to the development and construction period.

Market risk entails short and long term commodity price volatility. The significance of gas price risk is driven by the competitive position of a project on the cost curve. Higher cost producers face the greatest risk in low commodity price environments. To the extent that North Slope gas on a delivered basis is more expensive than gas from other sources, gas price risk becomes more pronounced in the minds of investors.

Construction Phase

As a result of the distinct differences between these two categories of risk, the capital markets will look at this project as two separate projects. One project begins when the first dollar of funding is invested and continues until the first quantities of North Slope gas are sold in the Lower 48. This is the construction phase, and the risks associated with this phase are almost entirely focused on completion risk. The project has no source of revenues and faces innumerable unpredictable challenges that could suspend the project. Completion risk may be borne by upstream producers, pipeline operators, gas offtakers, EPC contractors, or even governmental bodies. Regardless of who covers the risk during this phase, completion guarantees from a highly rated institution, group of institutions or governmental entity will be an important element in achieving a solid investment grade rating and in providing a saleable risk profile for the overall project. These guarantees could backstop all or a portion of the debt used to fund the project during the completion period.

The construction phase financing typically consists of both debt and equity, with the debt contributing the largest portion of the capital. In the case where a major corporation is an owner, these issues may be directly resolved by contract with the engineering and construction firm. The construction company may face penalties for delays or cost overruns, but ultimately it is the owner who is responsible for repaying the bond holders if the project fails. A commercial entity will almost certainly be required to provide support to the project during the construction phase and offer a completion guarantee. While the government's guarantee could provide for a lower cost of financing through additional security, lenders will ultimately look to the economic viability of the project, regardless of cost overruns or delays. Our view is that a governmental guarantee does not eliminate the need to structure the project in a commercially sound and economically viable way.

Precedents involving public/private partnerships have included a government backstop for a portion of the debt while preserving the benefits of mostly private ownership. A government institution might insure the most critical tranches of debt and look to benefit from a more financeable project or sometimes a percentage of the equity, and therefore the direct economic rewards.

In some past projects with a public/private partnership, the most secure debt has been funded first, laying the groundwork for layers of senior capital with greater risk/reward profiles.

Debt can be offered through bank construction loans, working capital revolvers or other channels which allow for a gradual increase in funding to match the capital expenditures. A layer of equity capital in major construction projects might be layered on last, and the upside for equity holders is embedded in the ability of the project managers to stay under budget. At the end of the project, the equity holder might continue to hold the equity, or be bought out through implementation of the permanent financing. By using a layered capital structure in this way, the project is able to generate the full cost of capital, and the controlling entity, the builder, is given incentives through economic rewards to complete the project in a timely and efficient manner.

Another consideration during construction is how to fund the regular interest payments on the debt financing. Because the project has no revenues, interest is usually capitalized. The economics of such pre-funding of interest can be negative, as the project carries debt levels above the amounts it requires for its current capex spending. However, in the current environment with rising interest rates, such “negative carry” may effectively amount to a rational insurance premium related to market risk around financing.

Operating Phase

The second major category of risk is associated with the market price of natural gas. Simply put, the issue is determining who bears the risk if the value of the gas at the wellhead falls below a level that allows producers to recover their costs and earn a return. Investors are accustomed to this type of risk and the private sector has developed a number of alternatives for managing and allocating market price risk.

Most market risk gets allocated through various usage agreements, and we expect that usage agreements will be the driving factor of the economics and post-completion financeability of this project. For the purposes of our discussion, we assume that the project is entirely pipeline because that is where we find the most comparable precedents, but the concepts apply equally to an LNG terminal or other transportation system. Tolling agreements offer one method of risk allocation, under which the pipeline’s return is capped by the tolls and the pipeline’s capacity. A tolling arrangement can also be very secure if high throughput volumes are expected. Investors in tolling pipelines face risk when the price of gas in the end market falls below some critical level where the market price equals the production and transportation price. In other words, the risk is that in periods of low gas market prices, either the producers, pipeline operators or offtakers would suffer a loss.

Pipeline operators who do not wish to take on the full risk of tolling agreements might opt for capacity agreements, by which the pipeline operators reserves certain capacities for contracted customers, thereby providing some minimal level of revenues even if no product is being shipped. For complete insulation from market price risk, there remains the “take-or-pay” agreement. Under this arrangement suppliers or offtakers commit to pay for portions of the capacity of a pipeline regardless of their usage level at generally fixed or contracted tariff rates. Take-or-pay agreements effectively lease a portion of the pipeline’s throughput capacity and make for effective financial guarantees depending on the credit quality of the committed customer.

As we’ve indicated, the credit strength of the project will be a function of the nature of the commercial and contractual arrangements among the producers, shippers and offtakers. One structure which would provide for this is if an offtaker or group of offtakers effectively provided a floor to gas prices. In doing so, they would help protect the credit of the pipeline to the extent of the gas that they had agreed to purchase. In exchange for supporting the floor price, the producers would agree to a ceiling price in the contract as well, resulting in a “collar” contract. In addition to

the capacity, the duration of the contract would be important, such that a bond would in theory receive credit support for all or a portion of its term. This will be a challenge given that natural gas buyers such as utilities are generally seeking shorter-duration contracts for their purchase commitments. We think that there would potentially be interest in such a structure, however, given the large number of gas buyers available to any of the routes under considerations. We believe that the fundamental economics of this project will allow for a diverse group of suppliers and customers capable of supporting the post-completion financing. If those parties are held to their commitments through effective contracts as provided by the structure of the project, we in the capital markets believe that the project will have little trouble finding financing for the operating business.

Financial Arrangements

We would like next to discuss more specific financial considerations that would likely apply to this project. While we cannot predict the circumstances of the financial markets, the risk and rewards that we described above will likely lead to certain outcomes.

We noted that just this week, the U.S. Congress approved loan guarantees of up to \$18 billion for this very project. This represents an important step forward in making the project a reality and we would expect this decision to promote commercial interests to take action. Essentially, Congress has set the financial cornerstone for the project.

Construction financing typically will consist of debt that is drawn down in increments to match the spending needs of the construction process. This type of interim financing can be arranged through bank credit revolvers, specific construction loans and potentially the commercial paper market. Given the size and lengthy construction period of this particular project, we think that accessing the bank market will offer the lowest cost and most flexible source of financing. The depth of the bank lending market will depend heavily upon the completion guarantees backing the construction phase. If the guarantee covered only a portion of the financing, or if the guarantee were backed by a less creditworthy institution, then the cost of the borrowing would rise accordingly and some additional structuring may be required.

The construction financing could also include a layer of equity, likely in the range of 20 - 30% for such a large capital project. As discussed before, the Alaska State government or one of its public entities may be a suitable equity investor for at least part of this amount. Other logical equity investors are producers, shippers, offtakers and pipeline operators. The timing of the equity is an important question and may depend on the nature of any completion guarantee, the role of the equity holders in the project and the amount of equity required. An equity holder would be more secure if the investment were made toward the completion of the project.

When construction is completed, the project may need to be refinanced with permanent financing. The timing of the refinancing is important because, unlike during construction, permanent financing must be entirely drawn in a limited space of time. An adverse change in the capital markets, though temporary, could significantly change the overall cost of capital for the project during much of its operating phase. Being aware of this refinancing risk and maintaining an active dialogue with bankers and lenders will help keep the cost of capital low. As completion nears, permanent financing should be secured when the cost is expected to be lowest given the time until the first revenues and the capital markets environment at the time.

Sources of debt for the permanent financing may include, broadly speaking, corporate debt, project finance debt, and tax exempt debt.

In a scenario in which completion is only partially guaranteed, the resulting structure would likely consist of a series of layers of capital with different levels of security. With the first and most secure layer backed by the Federal government, the following layers would presumably be more costly to the project. However, we see real potential for financing another layer with tax-exempt debt, thereby offering another source of low cost financing for the project. Depending on the size of this layer, the tax-exempt interest rate could be very close to the cost of federally guaranteed debt, if not less. Tax-exempt financing is available to projects that qualify as municipal utilities or government-owned facilities for the benefit of the public. Tax-exempt status is equivalent to a tax credit to the project, transferred in the form of lower interest payments. We believe that portions of this project could be segmented to qualify as state- or municipality-funded. For instance, compression stations, lengths of the pipeline or port facilities could be owned by the State or cities and financed separately. Alternatively, state agencies could issue bonds on behalf of the project (for example, those agencies could borrow in the tax-exempt market and lend in turn to the project). In addition to offering a lower cost of capital, the tax-exempt market also represents an additional source of funds and a different investor base, which could be important if a significant portion of the construction must be financed without an effective completion guarantee.

In some cases, permanent financing can be used to fund the project during construction. This is the case of QatarGas II, an LNG development project in Qatar. The rationale for raising permanent financing prior to completion is to avoid refinancing risk entirely and to access the debt/credit markets during an especially attractive time. Under such a structure, the financing terms provide for different pricing pre- and post-completion, as the completion guarantee falls away while the debt is outstanding. As noted at the beginning of our testimony, the current capital markets environment offers some of the lowest interest rates and tightest credit spreads ever. The forecast is that interest rates will rise steadily for the foreseeable future, and so “locking in” an interest rate now provides certainty of funds and cost thereof. The biggest consideration is that the project accrues interest payments during the construction phase on money that it may not need until later. However, if the owners determine that the incremental interest that must be capitalized up front may be outweighed by lower cost of debt going forward (and the elimination of some or all refinancing risk), permanent financing may be used to fund the construction process.

At the end of the construction phase, completion risk falls away and the potential for an increase in the value of the asset creates more room for equity financing. Debt will continue to make up the majority of the project’s financing – we would estimate about 70%. If the equity holders of the project are large corporations, they may choose to include the project’s debt obligations within the general obligations of the company, as companies typically do when they finance new capital expenditures. This would offer a lower cost of financing, but increase the cost to the sponsoring corporation. Many large energy projects, however, can support modestly priced debt on their own. So-called non-recourse, or project financing effectively treats projects as standalone companies, similar to revenue bonds, and is often used in energy projects. Tax-exempt debt would be equally beneficial to the project economics during the operating phase as it would during the interim construction period.

As mentioned before, offtakers, particularly large utilities or municipalities with substantial natural gas requirements, might provide critical support for the debt. With gas prices at all time highs, it is possible that a major utility or municipality would effectively provide a guarantee against a serious decline in market gas prices. That is, the utility or municipality would commit to buying fixed quantities of gas over a long period of time with the price subject to a floor. To ask an offtaker to take this risk, however, would also require some potential benefit, likely in the form of an upper ceiling on the price. This type of collar arrangement provides meaningful upside to equity holders, yet effective downside protection to bond holders. We think that given the parties

involved in the usage of the system, such an outcome would support the financing for the operating period.

The amount of equity used to finance gas pipeline projects has historically been low. An owner may choose to build extensions and laterals to new sources, but generally this upside is limited. Pipeline assets generate stable cash flow, but the immobility of the assets and capacity constraints do not provide much opportunity for growth. We note that this project may indeed have upside through up to 100 Tcf of potential gas resources yet to be discovered in the North Slope above and beyond the approximately 35 Tcf of reserves. In addition, most major pipelines are regulated by FERC, which usually limits equity returns to 10-15%. Excess returns often accrue to shippers through future lower rates. The risks of owning an operating pipeline are low, but so too are the returns.

Corporations represent a likely source for long-term equity in this project. The success of the companies producing the gas in the North Slope will be tied to their ability to deliver gas to market on reasonable terms. For that reason, they may seek to own and control the pipeline themselves. Offtakers, particularly those with energy trading operations, may see this pipeline as a promising opportunity as well. Pipeline companies may seek to invest in the equity in order to expand their reach and increase value by applying their experience in operating and managing gas transportation systems. Finally, the pipeline could be a standalone company. Equity could be issued onto the public markets as stock available to anyone. Importantly, we want to stress this point – that we believe the capital markets represent a potential source for the permanent equity in this project.

The State and Federal governments are also potential investors. The form of governmental involvement can be incorporated into the public/private venture model, similar to the structure that the government uses for privatizing government owned assets. In other major pipeline projects, regional governments have bought partial ownership stakes to the benefit of all investors. The State receives the value and fiscal gains associated with ownership, in addition to maintaining valuable access to information regarding the extent and use of its resources. At the same time, State ownership sends an important signal to equity and debt holders alike that the government is determinedly behind the project and committed to its success. Finally, government participation can simply serve as a significant additional source of capital. Even if government ownership represents 10% or less of the equity, the passive participation of the State will convince potential investors that the State is on their side.

Various classes of equity could be appropriate. Master Limited Partnerships, or MLPs, allow individual retail investors to own shares of a partnership which, unlike a corporation, is not taxed before paying dividends to its owners. Although the dividends are ultimately taxed as the investors' income, the lack of double taxation typically faced by corporations and their shareholders allows MLPs to pay higher dividends relative to the equity invested. Lehman Brothers has participated in the vast majority of MLP equity issuance since the beginning of 2004, and this structure has gained enormous popularity. Today the total size of the MLP market is approximately \$50 billion. The MLP investor community, however, is limited to the retail market. The tax advantages of MLPs are not available to institutional investors such as pension or mutual funds. MLP dividends qualify as Unrelated Business Taxable Income ("UBTI"), resulting in negative tax treatment for institutional investors. Other types of securities, such as Enhanced Yield Securities ("EYS") offer similar benefits by targeting the ability of assets to generate cash flows. In the case of EYS, an investor holds a single security that includes both debt and equity, preserving a degree of upside in an income-based investment. Our point here is not to recommend

a particular source of financing, but rather to point out that the capital markets are a source not just of debt capital but equity as well for this project. If the producers, offtakers and pipeline operators do not wish to own this project, or if the threshold rates of return are too high, then we believe equity related to this project can be sold directly into the capital markets.

The market capacity for various financing vehicles will also determine the project's ability to raise capital. As we mentioned before, the most secure debt, backed by the Federal government, is readily marketable. As the capital structure moves up the risk curve, the capital markets generally become less deep. At the same time, however, we are confident that if properly structured, the corporate bond market will have significant interest in this project. Alternative structures such as MLPs and EYSs on the equity side are the smallest of pools, but are growing rapidly and, with appropriate structuring, could provide a significant portion of the capital for this project.

The Role of Government

Although we are suggesting that a capital market solution will be able to provide a substantial portion of the financing, it is not without government involvement. The State and Federal governments will provide the opportunity for proceeding with the project in a joint venture or public/private venture which may include a contribution of equity, federal guarantees and subsidies, or other incentives in the form of tax-exempt financing.

We believe the key risk posed to the State of Alaska is that the project is not ultimately developed. The State would not necessarily be required to bear any risk in the financing and would gain immensely from the royalties and valuable information the project will generate.

We see the State's primary role as that of enabler or partner. An important first step was creating the Alaska Natural Gas Development Authority. The local, multi-jurisdictional and bilateral conflicts that are inherent in a pipeline project of this scale will require some state or federal level oversight to prevent potential hold-ups.

The applicable royalties on extracted resources should be made clear and consistent for the foreseeable lifetime of the project. Investors will look for assurance that regulators will not seek to undercut the economics of a successful project.

There remains room for more extensive and direct financial assistance by the State or Federal governments. Government incentives can greatly accelerate the commercial development of the pipeline and can significantly reduce the overall cost of capital. We will describe some of the advantages and disadvantages to various degrees of government support.

Much has been said publicly about the possibility to modify IRS tax accounting rules to promote the development of the project. Specifically, many parties have discussed accelerated depreciation (7 years versus the normal 15-year period) as a potential option. Under the current accounting rules, owners will not have deducted the full cost of their capital investment for 15 or more years. By accelerating the depreciation to 7 years, companies will be able to recoup part of their costs more quickly.

We have already discussed the potential for a governmentally-sponsored completion guarantee or equity investment. Obviously these represent the most direct involvement in the

project, and depend on the perceived needs of the financing and the fiscal objectives of the governments themselves.

Other actions by the Federal Government may help to expand the capacities of segments of the capital markets. A project of this size might rely heavily on certain types and sources of financing vehicles. Among others, these include tax-exempt debt and the yield-based equity securities discussed earlier. In order to qualify for tax-exempt debt, a project such as this would typically have to demonstrate qualifications relating to government ownership and direct benefit to the public. As such, tax-exempt financing for this project may be limited. Offering one-time exceptions to IRS rules would allow for more of this lower cost debt to support the project, lowering the cost of capital and thus raising the overall viability of the project. Similarly, the MLP structure is effectively limited to being held by retail investors, because institutions generally face a tax penalty for holding such stock. Given that institutional investors, such as pensions, mutual funds and other large investment companies, own approximately 60% of the equity of the top ten companies' in the S&P index, a one-time exception to the tax rules facing these investing institutions would create an extremely large source of demand for the project's equity.

Conclusion

We believe this project is not only feasible, but will also greatly benefit all parties involved. Lehman Brothers has the expertise, resources and experience in this type of transaction to help make this project successful. Assuming it is well structured, the financing will be well received by the marketplace, and this will facilitate funding and good execution for the project. All the proposed commercialization strategies can be readily financed, and Lehman Brothers will be happy to help evaluate the scenarios and develop a financial solution. We recognize that the capital markets can exhibit some volatility, but we have full confidence that a project such as this will be able to raise ample financing when needed.

Hopefully this discussion has helped to highlight the importance of a well designed capital structure. The inherent risks this type of project will face can be reduced by taking the right steps around contracts and structure. It is important for highly rated institutions to back the project from the very beginning in order to attain a saleable risk profile for the overall project. A strong credit profile will ensure strong ratings for the project and lower the cost of debt. Debt will be the largest source of funding throughout the project's lifetime, although the ownership of equity will drive the project's appeal to all investors.

We strongly believe the proposed pipeline project is important for the country's long term energy supply and beneficial for the stakeholders involved. As a result, we believe financing from the capital markets will be readily available and look forward to continuing our work on this valuable opportunity.