## Appendix T to Interim Fiscal Interest Finding dated November 16, 2006
## Chronology of Negotiations

### Background

This chronology of negotiations begins in January 2004 with the filing of the Stranded Gas Development Act applications and ends with the release on May 24, 2006, of a fiscal contract that contains both oil and gas terms. The State's efforts to prepare for the negotiations had actually begun as early as March 27, 2003 when Governor Murkowski held a day-long meeting with senior management officials from ConocoPhillips, BP, and ExxonMobil regarding the commercialization of Alaska North Slope Gas. All parties were looking forward to passage of HB16, the renewal of the Stranded Gas Development Act, filing an application under the Act, and passage of federal enabling legislation. The Departments of Revenue, Law and Natural Resources, assisted by various outside consultants, led the State's preparatory efforts.[1]

Two benchmarks of the early effort were: (i) the development of the August 15, 2003, State concept for an SGDA contract, and (ii) the October 2003 DOR comprehensive economic model of the total pipeline project. The DOR model would serve as the foundation for models of the project subsequently development by DNR and the State's consultants. Runs of the economic model confirmed that under stress prices of \$3.50 per MMBtu, the economics of the project were dismal. That served to confirm DOR's opinion that the gas on the North Slope was stranded.

The August 15, 2003, fiscal contract concept incorporated a fiscal stability period for gas based on an "R" factor, whereby the duration of the stability period was one and

[1] Another early step that was helpful to a gas line was the signing of a cooperative accord between Alaska and the Yukon Territories on December 1, 2003.

one half times the period of "payout." In other words, once investors had recovered 150% of their cumulative investment, fiscal stability for gas would terminate.

The chronology that follows was developed from the record of gas line documents and personal recollection of key events. A complete history of the negotiations would fill volumes and would require permission from the Sponsor Group[2] and TransCanada to release specific confidential data. The State does not have such permission. Accordingly, the history was developed from publicly available documents and certain other State documents. The Administration believes that this chronology will serve to create an accurate, lasting public record of the path of the negotiations.

## Early 2004 –SGDA Applications are Filed; Formation of the Municipal Advisory Group; Negotiation with MidAmerican and Discussion of Option A with the Producers

In the first half of 2004, the State worked on the gas project on three fronts.[3] First, the State intensified its discussions with the Sponsor Group about the economic framework for a gas project and a process for advancing the negotiations. Second, the State negotiated on a fast track with MidAmerican Energy Holdings, a Warren Buffet

[2] The Sponsor Group companies, sometimes referred to as the producers, are BP, ExxonMobil, and ConocoPhillips.

[3] The State received five SGDA applications. The first application was that of BP and ConocoPhillips, filed on January 13, 2004. ExxonMobil Corporation joined that application a week later even though the State indicated that an over-the-top route would not be considered as part of the application, an option that ExxonMobil continued to advance but later dropped. That application was approved three days later and the three producers subsequently signed a reimbursement agreement. MidAmerican filed its application on January 22, 2004, and it was accepted by the State; however, it never signed the necessary reimbursement agreement with the State. AGPA submitted an application on February 27, 2004, which it later withdrew and resubmitted in March 2005. ANGPA's resubmitted application was conditionally approved on May 5, 2005, but the ANGPA never submitted the requisite information to show that it was a qualified sponsor under the SGDA. Enbridge submitted an application on April 30, 2004, which was accepted but a reimbursement agreement was not signed and negotiations did not proceed. TransCanada's SGDA application was filed on June 1, 2004, and accepted a few weeks later. A reimbursement agreement was entered into in late August 2004.

controlled company, which wanted to submit a fiscal contract to the Legislature by mid-March of that year. Third, the State began informal discussions with TransCanada concerning its concept of a gas project. In addition the State formed the Municipal Advisory Group (MAG) pursuant to the Stranded Gas Development Act to advise the State during the contract negotiations. The MAG ultimately passed 8 resolutions to advise the State on the initial contract negotiations and 10 additional resolutions advising the State of the MAG's position on the May 24, 2006 fiscal contract.

**The MidAmerican Discussions**

The discussions with MidAmerican moved quickly but ultimately were unsuccessful. MidAmerican sought an exclusive right for three to five years to negotiate a fiscal contract and pipeline right-of-way lease across State land. MidAmerican also sought a take or pay capacity commitment from the State equal to, for example, the State's share of royalty gas. MidAmerican also sought a 25 year fiscal certainty period, an exemption from certain future taxes, designation of a permitting czar with authority to grant municipal permits, dispute resolution by arbitration outside Alaska, and an opinion of the Attorney General on fiscal stability. On its part, the State sought work commitments that contained specific deadlines for the completion of necessary studies, for obtaining commitments from the producers and Canadian pipeline companies, and for the filing of the FERC application. MidAmerican rejected the concept of a timetable with specific requirements. The State also sought open access and in-state gas availability terms that MidAmerican was not prepared to accommodate. The State also proposed tariff provisions that would specify the economic parameters for calculating the tariff. MidAmerican broke off negotiations with the State in mid-March and then, at the request of the Governor, returned for an additional round of discussions later that year. In those negotiations MidAmerican asked for a period of exclusivity during which the State could not negotiate with any other parties. Those discussions also proved unfruitful and they withdrew from further negotiations in mid-summer 2004.

**Producer Talks**

Concurrently with the MidAmerican talks, the State began discussions with the producers about their SGDA application. In an effort to move negotiations quickly, the State put forward a draft fiscal contract early in the discussions that contained its preliminary views on various issues but was incomplete on critical economic terms.[4] In fact, the draft contract contained blanks, e.g., for the amount of the payments in lieu of taxes, for the field cost payments and for the transportation allowances that were necessary to calculate gas value.

The core of the proposed contract was that the existing fiscal system was to be simplified by use of a sponsor payment in lieu of taxes ("SPLT") and that fiscal certainty would be provided for either a fixed term or when a target revenue amount had been reached.[5] Production, corporate income, property and municipal sales taxes were all to be replaced by a single payment under the contract --the SPLT. The SPLT itself was

[4] The draft was delivered to the producers on February 17, 2004. As it did so, the State was careful to note that it did not have either the benefit of input from its consultants or the information and data that were to be provided by the Sponsor Group.
[5] The State proposed a term for fiscal certainty that revolved around a four phase concept - planning, construction, investment recovery and risk reward.

divided into a shared SPLT and a profit sharing SPLT. The former would consist of a fixed payment during the construction period and a fixed, per MMBtu amount from the commencement of commercial operations, both adjusted for inflation. The profit sharing SPLT would require a payment of North Slope profits from gas measured on a netback basis. The State's fiscal stability guarantee would expire either at 15 years from the commencement of commercial operations or when project revenues had achieved a gross value of $40 billion measured by the value of MMBtu's transported across the Alaska border multiplied by the AECO price.

The State proposed general work commitments subject to further definition and an option to buy 12.5 per cent of the pipeline at the commencement of commercial operation. Royalty valuation provisions for gas would be negotiated three years after start up once actual gas sales data had been accumulated. The producers would be required to transport the State's royalty gas at a nondiscriminatory rate and give "explorers" a right of first refusal on expansions of the pipeline. The State also proposed a detailed set of requirements for open season on the pipeline. For in-State use, the State sought a mileage based toll, a .3 Bcf / day reservation of capacity for in-state use until compressor stations were ordered and a .1 Bcf/day reservation thereafter. Arbitration would be used to decide disputes related to specific factual matters. The contract would terminate if commercial operations had not commenced by December 31, 2013.

The central idea of the mid-February contract - that the fiscal terms would be defined as a single payment in lieu of taxes, and the State's royalties would be taken under existing law with the details of valuation determined at a future date - became known as Option A. The Sponsor Group rejected Option A. The objectives of the Sponsor Group came down to three fundamental principals: "predictability, enhancements, and durability." It sought an unambiguous contract lasting for 35 years from the commencement of commercial operations, settlement of disputes through arbitration, fiscal stability (no increase) in oil taxes, integration of the Point Thomson field as part of the project, and economic enhancements achieved through a lowering of the State's governmental take below the status quo.[6]

The State's basic objective was to secure a project that would result in a wide range of benefits and to maximize the benefits for the State. The State also urged working from draft language as the best means of understanding how principles would be applied. By putting forward its conceptual draft of February 17, 2004, the State demonstrated its preferred approach.

The Sponsor Group was committed to a deliberate, step by step approach. It suggested a series of workshops on a dozen topics such as fiscal stability, economic "enhancements," open access and in-state use, and dispute resolution. The Sponsor Group sought to agree on principles first, apply those principles to resolve specific issues, and then draft language.

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[6] On February 23, 2004, the State began additional consulting studies related to the modeling of gas prices, in particular the AECO differential, the possibility for petro-chemical industries in Alaska and the due diligence on the capital and operating costs of the data room study of the Sponsor Group.

**April 5, 2004**

The Governor met with the Sponsor Group about developing a "road map" for the negotiating process. The parties quickly settled on a common approach that reflected both sides' positions. It was agreed that a series of workshops would be scheduled through the spring and early summer to develop a common understanding of major issues. Agreement would be sought on a protocol for protection of confidential information so that the State could have access to the Sponsor Group's data and studies. The State also agreed to work further on refining a new draft contract and on adding specificity to the benefits it sought. The State also sought to develop major economic models that would enable it to evaluate the value or cost of particular options in the negotiations. The Sponsor Group promised to support the development of these models with data.

As part of the process, in early April, for example, the State met with the Sponsor Group to describe in greater detail the "benefits" it sought. The benefits included optimization of State revenues, timely construction of the project, an option for the State's equity participation, provisions for in-State gas use without subsidization, provisions for access that built upon FERC's requirements and provided access for future explorers, provisions for Alaska hire, training and contracting, and the possibility of the use of liquids for a new petrochemical industry in Alaska. The State agreed to look at the question of the economics of the project as part of an enhancements workshop.

**<u>April 7, 2004</u>**

Dr. Pedro van Meurs, the State's lead negotiator at the time for the project and a leading international petroleum economist[7], made a presentation to the Legislature that highlighted the fact that the profitability of the project was poor but could be enhanced through:

- Fiscal stability
- Risk sharing and participation with respect to the royalties
- Various provisions under the then-pending Federal Energy Bill

Dr. van Meurs also explained the concept of firm transportation ("FT") commitments and how this affected the ability to finance the pipeline

**<u>May 12, 2004</u>**

The State and Sponsor Group continued negotiations to delineate areas of disagreement on the State's proposed contract terms and to study the duration of the fiscal stability period, and agreed to attempt to achieve an October 2004 deadline for an agreement. The State proposed to simplify the deal to achieve that date.

**Development of Options A, B, C, D and E** – In its efforts to simplify the deal, the State developed and evaluated various alternatives for a fiscal structure for the project:

[7] Dr. van Meurs has served as an outside adviser to the State on gas and petroleum tax issues since 1997, and served as lead negotiator for the State in gas line discussions until May 2005. Dr. van Meurs has advised more than 70 sovereigns in designing petroleum tax regimes and in petroleum negotiations. His initial work for the State was instrumental to the enactment of the Stranded Gas Development Act.

- **Option A** - the plan that had already been submitted to the Sponsor Group in mid-February: in short, a SPLT in lieu of major taxes and royalty as is.
- **Option B** - the State would take its royalties in-kind and undertake responsibility for its own shipping and marketing.
- **Option C** – the State would take its royalties in-kind and convert its tax payments to in-kind gas and take the entire amount as payment in-kind. The State would also take an ownership interest in the project.
- **Option D -** which involved offering a fixed percentage royalty on gas as well as on condensates being produced along with the gas.
- DNR was separately developing an **Option E** which they would introduce shortly.

The State negotiating team decided to present Option C to the Sponsor Group on a conditional basis.

The State's internal task was to start studying the feasibility of Option C. The State's risk sharing and participation involved a large number of new issues. Therefore a two month study program was set up to evaluate these matters: Merrill Lynch was contacted to study the potential for financing the State's share; the Department of Law and its legal consultants undertook to evaluate the legal and constitutional aspects of incurring State debt for a private project of this nature and organizational and the tax issues; and DNR and Dr. van Meurs worked on improving the State's economic models.

**May 14, 2004**

The Sponsor Group provided more detail on a roadmap to project completion. The roadmap resembled the year by year chart of activities that was part of their SGDA application, but contained more detail and referenced the common path of obstacles to large project development. The Sponsor Group also made an analogy to a three legged stool to secure a project: one leg was federal enabling legislation to address uncertainties and unresolved issues at the federal level, a second leg was an SGDA contract with the State to provide a fiscal foundation for the project in the state context, and the third leg was clarifying the Canadian regulatory framework. All of this was a predicate to the Sponsor Group making a more definitive analysis of the economic viability of the project.

**June 1, 2004**

TransCanada filed its application under the Stranded Gas Development Act and, jointly with the Alaskan Northwest Natural Gas Transportation Company, requested that the State resume processing their application for a pipeline right-of-way lease across State lands.

**June 16 - 17, 2004**

The Legislature's Legislative Budget and Audit Committee convened hearings on SGDA gasline negotiations with all parties involved in order to begin the process of informing themselves with respect to SGDA contract matters.

**July 1, 2004: Option E - DNR's Proposed Option E**

- Option E was an innovative approach to the project that contemplated taking the State's royalties and taxes in kind.
- However, contrary to Options B through D, the State would sell 95-97% of all its gas to a third party prior to the first open season, and the third party would be responsible for the FT commitments.
- The State would be granted an option for an ownership interest in the pipeline.
- The value of royalty in kind/royalty in value ("RIK/RIV") switching and other values inherent in the lease agreements would be crystallized in a slightly higher percentage share.

Option E was a concept that, compared with Option C, combined the best of both worlds. The Sponsor Group would benefit from the increase in the internal rate of return ("IRR") as a result of the fact that third parties would take a share of the FT commitments, and the State would not be responsible for the FT commitments. This would reduce the exposure to the State.

The main and clear drawback of Option E was that it required a deal with third parties that would be done after the stranded gas contract would be signed. In other words, it was necessary to first complete an agreement with the Sponsor Group. It was decided to make this a conditional deal. Therefore, it seemed that Option E was really a logical follow up to Option C. One could negotiate Option C first and at the same time continue to work on Option E. Option E required more work and, in view of the short time line, it would be good to start negotiations on the basis of Option C, with the condition that the State could change and enhance it towards the Option E concept later.

In July of 2004, the Governor and the Gas Cabinet decided to move forward with Option C as the most feasible plan for an early gas project. It could provide for enhancements to make the project economics yet allow the State to retain full value for its gas and taxes.

**July 20, 2004: State Presents its Option C Plan to Sponsor Group on a Conditional Basis.**

- The key feature of Option C was that the State would take gas royalty in kind and would also receive payment of gas production taxes with gas, not cash. Tax gas and royalty gas would be dealt with as two separate streams, rather than as a single percentage.
- Municipality property tax obligations were not included.
- The State and the Sponsor Group sought to reach an agreement in principle on the main issues and a more detailed agreement by early February 2005.

The State team continued its internal analysis of Option C:

- DNR undertook more research on the premium that the State should receive on the value of the gas in view of the lease conditions. Lukens Energy Company did much of this work.
- The Lukens Group also looked into how the State would create a gas marketing organization. The Lukens Group's experience advising the U.S.

Department of Interior Minerals Management Service's pilot royalty marketing program was particularly useful.

- DOR and DNR worked with Ziff Energy to get a better assessment of the possible differential between the AECO (the Alberta Hub) price and the Chicago gas price. This was to better evaluate a project going only to the Alberta Hub.
- Merrill Lynch completed a financial analysis that was presented to the Sponsor Group.
- Roger Marks, Greg Bidwell, other DOR personnel and Dr. van Meurs continued to improve the economic models. Dr. van Meurs tailored DOR's original model toward the negotiations – that came to be known as the PVM model.
- DNR and Lukens worked on a large integrated gas price model in order to evaluate future gas prices on a probabilistic basis.

**Mid-July 2004 – Plan C Takes Shape**

The State analyzed the issue of the duration of the period of fiscal stability in more depth. Based on the results of the PVM model, it became apparent that under stress price scenarios, the project was not particularly attractive. Given this economic environment, using an R-factor concept in order to define the term of fiscal stability would not work well for the State. Under low prices and high costs fiscal stability would extend for a reasonable period. However, under high prices and low costs, the economics would push the fiscal stability period out longer than necessary. Based on this study, the State started to work on a concept of a more traditional contract term.

On July 23, 2004, based on an extensive study of all production sharing contracts, Dr. van Meurs recommended to the Gas Cabinet that it adopt a total period of 35 years from the effective date for the term of the contract. This recommendation was accepted and put forward to the Sponsor Group on July 29th.

The next day, the Sponsor Group responded with its initial reaction to the modified Option C. The reaction to the overall structure appeared positive. The Sponsor Group liked the concept of taking gas in kind for both royalties and taxes. The fact that the State would be sharing in the risks and investments was also positive in their view because it provided for a much higher degree of alignment between the State and the Sponsor Group, and eliminated the possibility of years of litigation over gas valuation for tax and royalty purposes. The Sponsor Group also thought that it would aid alignment of the parties if disputes under the contract were subject to binding arbitration, not litigation in the Alaska courts.[8] It suggested that the State should receive a midstream payment in lieu of property taxes in terms of cents/MMBtu. Also upstream payments in lieu of property taxes could be defined in terms of cents/bbl. The Sponsor Group felt that the State's package did not present the "enhancements" that they were seeking. Nevertheless, there was a generally positive response to the package.

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[8] The Sponsor Group had great difficulty in agreeing on dispute resolution procedures and its offer of a proposed set of dispute resolution procedures was one of the last articles to be presented to the State.

**July 29, 2004**

The Legislative Budget and Audit Committee held a public hearing to review gas pipeline issues. Agrium, Enstar, Enbridge, TransCanada and ANGDA each made presentations. TransCanada's presentation on so-called "B to C" transportation issues between Alberta and Chicago was of particular interest. TransCanada argued that the best option was to tie into the Alberta Hub. It was estimated that, when the pipeline was finally completed, there would be considerable existing take-away capacity from Alberta. TransCanada estimated that at most about 2 Bcf/day of new capacity would be needed in 2012 to transport gas from Alberta if the Alaska gas pipeline were built.

**August 2004**

The State engaged a Canadian law firm, Osler, Hoskin & Harcourt, LLP, to assist with the Canadian aspects of pipeline legislation and in determining how a pipeline joint venture between the State and the Sponsor Group would be created in Canada. Dr. van Meurs and the State's internal economic team worked with Lukens economic modelers and improved the tariff methodology in their respective programs. In August the State also received reports from PFC Energy on relatively lower IRR fields, such as Ormen Lange in Norway, in order to serve as a basis for benchmarking.

**August 18, 2004: Proposing an LLC**

The Sponsor Group presented its thoughts of the organizational structure of the State's participation in the pipeline company. Its preference was to form a Limited Liability Company (LLC) to own the Alaska portion and any Lower 48 portions of the project. They outlined the benefits of such an organization to the State, including the fact that LLCs are a customary commercial entity commonly used in domestic energy projects. The State's independent work would lead it to similar conclusions.

**August 23-24, 2004**

It had become necessary to clarify on the State's side the financial, organizational and legal issues relating to the State's participation in the project. On August 23-24, 2004, the State team held a significant meeting in Seattle at which all of the State's experts and Merrill Lynch came together to try to resolve issues. However, at this meeting a large number of legal and debt issues were identified that still needed resolution before the State could even agree to Option C in concept

**September 1, 2004**

Responding to the Sponsor Group's comments on July 30, the State proposed a total property tax (State and municipal) for the midstream (GTP and the Mainline) of 8.5 cents per Mcf.

**September 17, 2004 - ConocoPhillips Makes an Independent Fiscal Offer**

ConocoPhillips broke ranks from BP and ExxonMobil and independently presented a full fiscal offer. BP and ExxonMobil were invited to hear the proposal. The State considered the offer and decided both that it did not provide a basis for advancing discussions and that it did not make sense to start any negotiations on a single company basis. The State, therefore, did not respond to the offer. As it looked forward, the State wanted to complete its ongoing economic analysis and, in the meantime, continue discussions of non-fiscal issues with all three producers.

**September 22, 2004**

In the fall of 2004, the State had begun to focus on the structure of the entity that would own the gas line. In September, the State received a much more detailed presentation on the LLC issues from the Sponsor Group together with a brief outline of the pipeline framework and the State team reviewed and provided preliminary comments. The essential outline was that the gas line would be owned by Alaska Gas Pipeline Company, LLC, a Delaware limited liability company, which would enter into an operating and construction services agreement with an affiliate of one of the Sponsor Group which would be the Operator of the project. The parties did not negotiate the term sheet, but the Sponsor Group undertook to develop a first draft LLC Agreement to present to the State later in the year.

One of the threshold issues the State team reviewed on a preliminary basis was whether Delaware was the appropriate place to form the proposed LLC. The conclusion was that as a general matter it was appropriate if not preferable, but the State wanted to see the Sponsor Group's proposed LLC Agreement. With over 150,000 Delaware LLCs in existence, Delaware is by far the most commonly-chosen jurisdiction for entity formation within the United States, especially for complex and sophisticated commercial ventures. The State concluded that there were unique benefits to using Delaware law, including (i) greater flexibility and freedom of contract, (ii) a broad body of established case law, and (iii) significant judicial experience and expertise with respect to LLC and commercial disputes. Each of these factors contributes to a relatively high degree of predictability of outcome available under the Delaware LLC Act and body of case law. Sophisticated commercial parties value this predictability of outcome because it mitigates the risk of litigation and other expenses and ensures that the parties have certainty with respect to their agreements regarding the governance of their venture.

**September 23, 2004**

The State notified the Sponsor Group that the Governor was interested in making an announcement about the equity participation of the State in the project and that the State would provide testimony on this subject to the Legislature on October 13, 2004.

**October 12, 2004**

The U.S. Congress passed the Alaska Natural Gas Pipeline Act ("ANGPA"). ANGPA resolved or clarified many of the issues that were attendant to the permitting of an interstate Alaska natural gas pipeline. ANGPA:

- resolved the uncertainty over whether a new party could file an application for an Alaska gas pipeline,
- created a clear and expedited process for action upon a certificate application,
- created a central coordinator for the issuance by other federal agencies of any necessary permits for a pipeline,

- gave the FERC unprecedented rights to order expansion of the pipeline upon complaint by an interested party,
- required the FERC to adopt Alaska-specific open season regulations on an expedited basis,
- confirmed the jurisdiction of the Regulatory Commission of Alaska over any in-state lateral pipelines,
- gave the State specific rights with respect to the shipment of royalty gas for in-State needs,
- confirmed the authority within limits of the federal government to update the terms and conditions of the ANGTS and preserve certain rights it had under the 1976 statute, and
- authorized an $18 billion loan guaranty for the project. (A more detailed memo on this matter is attached to this document as Annex 1.)

This had an enormous impact on the negotiations. One leg of the Sponsor Group's three legged stool was firmly on the ground. It was now clear that the onus was on the Sponsor Group and the State to reach the necessary agreements to get the project underway.

**October 13, 2004**

The State outlined to the Legislative Budget and Audit Committee (with non-Committee Members present) the concept of equity participation by the State.

**October 23, 2004**

The State reached internal agreement on how to deal with the net profit sharing ("NPS") issues relating to Point Thomson.

**October 26, 2004**

Representatives of the State's gas team made an initial presentation to the Governor about the entire Option C proposal.

DNR staff developed an innovative proposal, an "S curve" whereby under low gas prices the State would make payments to the producers, but at higher gas prices the State would receive significant payments from them. This proposal contained a progressive feature. The curve was called the Price Differential Payment (or PDP), since it was based on a price differential relative to the Chicago price. The Governor authorized the negotiating team to present this proposal to the Sponsor Group.

**October 29, 2004: The State Offers a Term Sheet on Option C**

On October 29, 2004, the State put forward a term sheet that contained the State's Option C proposal to the Sponsor Group. A copy of the proposal is provided in Annex 2 to this document. The main principles of the October 29, 2004 proposal were as follows:

- Provision of fiscal stability for 35 years from the signing date on the gas terms and certain oil features (such as property taxes per barrel on North Slope facilities). Fiscal stability on oil generally was not offered.
- Royalties, severance tax and net profit shares would be taken in kind at the inlet of the GTP. Royalties in kind would be based on the specific

percentages in the existing leases. Point Thomson NPS would be converted to a sliding scale royalty. Severance tax would be determined using the 2005 Economic Limit Factor ("ELF") formula for gas.

- There would be a PDP based on $3.50 in Chicago. Below this price payments would be made to the Sponsor Group, above this price payments would be made by the Sponsor Group to the State.
- The State would be an equity participant through an LLC structure and would be shipper and marketer of its own gas. The ownership percentage would be based on the approximate gas throughput volumes. This figure was set at 22%. The figure was also subject to acceptable arrangements on capacity.
- Property taxes would be converted on a cents/MMBtu basis to 7.87 cents/MMBtu for the midstream. A $125 million impact fund would also be established. Upstream gas property taxes would be based on an AECO sliding scale price formula. There would also be a $0.50 per barrel property tax on existing oil facilities.
- The corporate income tax would be unchanged for upstream operations, but would be based on a cents/MMBtu basis for the midstream and for gas ring-fenced in order to ensure stability.
- No upstream cost allowance was proposed.

The 22% initial State participation was determined based on the fact that the producers were demanding a fixed royalty on the gas from Point Thomson and DNR was seeking to set the fixed royalty at 16% in order to protect the State's interests in the absence of a final determination of the royalty share for Point Thomson.

The Sponsor Group appeared disappointed, but indicated that it would respond to the proposal seriously.

**November 1, 2004**

The State authorized a package of new consulting studies and background activities. This included an independent review of Ormen Lange and the Qatar Gas project in order to get a better handle on competing projects. During the preceding year DOR and DNR had developed the so-called "big" model based on DOR's original modeling work. An independent report by an IBM consultant confirmed that the PVM model and the "big" model gave essentially the same results based on the same inputs. The "big" model dealt with both oil and gas, while the PVM model only analyzed gas.

Meanwhile, FERC issued a Notice of Proposed Ratemaking for its proposed open season regulations and called for comments by mid-December 2004.

**November 29, 2004**

The State and Legislature reached a common position on the FERC open season regulations which turned out to be very significant in view of the fact that the FERC Commissioners were to make a special visit to Alaska to hold a public technical conference on the open season rulemaking in December 2004. The common

State/Legislature position played a significant role in FERC ultimately adopting favorable open access regulations as the State had urged. In fact, most of the Alaska parties who spoke at the FERC technical conference supported the need for a broad but detailed set of open season requirements.

**December 15, 2004 - Producers Respond With a Full Contract and LLC Agreement**

On December 15, 2004, the Sponsor Group delivered to the State a comprehensive counter-proposal to the State's October 29, 2004 term sheet. The Sponsor Group produced a complete proposed fiscal contract and a complete proposed LLC agreement. These documents ran several hundred pages in length. Over the next few days, the Sponsor Group walked the State through the key provisions of each agreement and explained the rationale of the economic terms that were included in each draft. December 15, 2004 was a major milestone on the road to a fiscal contract. With the package of December 15 terms, each side had staked out its opening position. The range of difference between the two positions established the size of the battleground for future negotiations. It was reasonable to anticipate what in fact happened--that the resolution of many core economic terms would end up somewhere near the middle between the State's October 29th proposed economic terms and the Sponsor Group's December 15 package.

The LLC Agreement was based on commercial agreements that the Sponsor Group has used for their ventures around the world. It covered a broad range of topics, including: corporate governance; capital contributions and penalties for failure to fund; voting; operation of the Management Committee that would be the decision-making body of the project LLC; distributions, capital accounts and tax matters, mechanics of undertaking expansions, transfers of interests, the mechanics of developing a finance plan for the project and miscellaneous sections. The State team agreed to review the draft in detail and meet with the Sponsor Group team in January to discuss it.

**December 15, 2004 – January 15, 2005 - Review of the Sponsor Group Proposal**

The State's negotiation strategy was to finalize all the non-financial issues before detailed negotiations could commence on the fiscal terms.

**December 20, 2004**

The State's gas team finalized a detailed draft of a proposal for the work commitments. These commitments were drafted on the basis of three specific phases until the start of commercial operations of the line, with specific time frames. Also the work commitments provided for an intensive work commitment in financial terms, with a requirement for monthly minimum expenditures. The work commitments had "off ramps" in case economic conditions no longer would justify the continuation of the project. The work commitments also adhered to the Governor's specific instruction to have a target date of 2012 for commencement of commercial operations of the gas line.

**December 27, 2004**

The State completed the first full economic analysis of the Sponsor Group's December 15 proposal and a comparison with the State's October 29, 2005 proposal. The most interesting result of the analysis was that the two proposals were not far apart with respect to either the IRR or net present value ("NPV") to the investors. However, under the Sponsor Group's proposal there was a large increase in cash to the producers and therefore a decrease in cash to Alaska. Only two thirds of the decrease in cash to Alaska would have gone to the Sponsor Group. The rest would have gone to federal government in income taxes. There was little to justify why the Sponsor Group claimed its proposal would result in an "economic" proposal and the State's would not. On this day the Governor also announced the concept of an Alaska investor fund whereby anyone could invest in the eventual gas line.

**Early January 2005**

The Governor started the year with an announcement in his State of the State speech that he intended to revamp the administrative procedures for collecting the oil and gas production tax. He administratively aggregated the Prudhoe Bay satellite fields, which resulted in a significant increase in the Economic Limit Factor (ELF). The consequence of this was that the State would collect between $100 and $300 million more production tax per year. This was criticized by industry and the Prudhoe Bay owners initiated the formal appeals process.

Also, DNR negotiations with TransCanada intensified and were conducted on a separate track. The negotiation details are confidential. Agreement between TransCanada and DNR on a draft term sheet was reached in the early summer of 2005. *See* pp. 34-35 below.

**<u>LLC Team Negotiations and AK Pipe Co.</u>**

Representatives of the State and the Sponsor Group met in January to review the initial Sponsor Group draft LLC Agreement and thereafter began frequent meetings in person or by conference call to explore various issues. It became clear that the Sponsor Group had established two negotiating teams – one for the fiscal contract and another to negotiate the LLC Agreement. Over time, the State decided as well to designate a specific State negotiating team for the LLC headed by Steve Porter, Deputy Commissioner of Revenue, and comprised of legal staff in DNR, DOR and the Department of Law with support from outside counsel.

One of the initial issues that arose from the negotiations revolved around exactly how the State would own its interest in the LLC, as this had significant implications for the structuring of the LLC itself. Would the ownership interest be held by a department directly? Would it be held by a public corporation? What would the entity look like in terms of corporate governance and powers? Would it have the authority to undertake major financial commitments, keep information confidential, and be separate from the enforcement arms of the State? There were many issues to address in structuring the ownership of the State's interest.

One of the key goals of the State was a desire to insure that decisions on the LLC level were made on as commercial a basis as possible under Alaska law. This led the State team to conclude that the State's interest in the LLC should be held in a public corporation that could act and in a commercial manner somewhat independently from the

State. Working with the Department of Law's legislative team and outside Alaska counsel, the State LLC team developed an initial draft of a public corporation statute that would authorize the formation of the Alaska Natural Gas Pipeline Corporation, a public corporation established under DOR. The State provided this draft to the Sponsor Group in July 2005. This began a process that ultimately led to the introduction of an AK Pipe Co. statute in the Legislature in May of 2006.

The State team contemplated that AK Pipe Co. would be staffed by experts and managed by a Board of Directors, the majority of who would be private citizens with relevant experience. AK Pipe Co. would have statutory authority to raise funds so that it could make required capital contributions to the LLC as a full member. The State wanted to ensure not only that AK Pipe Co. initially be granted appropriate powers and have the autonomy to act in a commercial manner but also that it would be a stable and reliable partner throughout the project's development, construction and operation. This was a fundamental premise of the State's approach to the AK Pipe Co. legislation.

By proposing that AK Pipe Co. be established as an autonomous public corporation within the State to hold the State's LLC interests, the State was able to address many of the possible concerns regarding voting and conflicts of interest that could have precluded AK Pipe Co. from having an effective voice in the management of the LLC and allowed the State team to argue for additional voting rights that put it on a more equal footing with the Sponsor Group in managing the project.

Another significant issue in the LLC team negotiations related to the terms and conditions of funding capital calls to meet the LLC's cash needs. The State wanted to ensure that the four partners could not hold up funding the often daily critical funding needs of such an enormous project, but at the same time the State team had unique funding issues to address due to the special requirements of the legislative budgeting and appropriations process, the possible issuance of revenue bonds and, longer term, how the State would protect itself from potentially open-ended cost overruns and completion risks. Overall, the State team believed that the State's proposed draft LLC Agreement provided a balanced resolution of these issues from the State's perspective.

**January 15, 2005 – June 30, 2005 - Planning for Negotiations with Producers and the First Major Round of Negotiations**

By mid-January the State had re-worked its negotiating plan. The State would develop a merged draft of the Sponsor Group's December 15 fiscal contract and the State's proposed contract, resulting in a single document that contained the proposed terms side-by-side. From that draft, there would be a joint effort to come up with common language when there appeared to be similar, but not identical, approaches to an issue. Point Thomson issues also would be addressed and resolved. More detailed substantive discussions were to be held in February with the idea that the major remaining issues would be decided at a high level in the month of March.

In January and on other occasions throughout the negotiations until October 27, 2005, sharp differences occurred in the Gas Cabinet between DNR and DOR on the positions that the State should offer in the negotiations. There were differences on not only the terms the State should offer at a particular juncture but whether the State should make counter-proposals. The Administration's intent was to offer positions that the Gas Cabinet had endorsed but progress was slowed by the need to resolve the internal differences. On more than one occasion, when the Gas Cabinet could not reach a common position, the ultimate State position was decided by the Governor.

**February 23, 2005**

At this point, the State had prepared a new draft of the work commitments. This draft still addressed all the main issues as the State had initially proposed, such as a specific obligation to be in service by Dec 31, 2012, specific minimum work obligations per month and specific time frames. However, the draft also introduced more flexibility. For instance, the Sponsor Group could defer development when the Chicago gas price was low.

**March 7, 2005**

A new fiscal proposal was endorsed by the Gas Cabinet with the unanimous approval of DOR, DNR and the Department of Law, and was presented the next day to the Sponsor Group. The proposal contained the following elements:

- Reduction of the Midstream PILT from 7.87 to 7.1 cents/MMBtu.
- Reinstating the full corporate income tax (ring fenced for gas and both PTU condensates and oil).
- A flat 7.25% severance tax rate for gas.

- A flat 11% production tax for oil and condensates from the Point Thomson reservoirs and a flat 5% production tax for shallower fields.
- Gas and oil royalties for PTU based on the result of the Unit discussions.
- Extension of fiscal stability to PTU condensates and oil.

State analysis at the time indicated that this proposal would actually generate more cash for the State than the October 29, 2004 State proposal.[9]

Members of the Sponsor Group expressed their disappointment that the March 7, 2005, proposal did not represent a significant concession. One aspect of the proposal that was attractive to ExxonMobil was the inclusion of elements of the Point Thomson issue in the fiscal deal. The Sponsor Group reaction was discussed with the Governor on March 16, 2005.

During this time, a unified draft side-by-side contract was developed which provided a useful vehicle for the resolution of a number of clauses and for clarification of the differences on other clauses.

**March 17, 2005**

The Sponsor Group sent a letter to the Governor with a proposal for accelerating the negotiation process. Essentially, this proposal called for regular direct meetings between the Sponsor Group and the Gas Cabinet. It also provided for a commitment on the part of both parties to dedicate the necessary resources to the project.

[9] The second, third and fifth items on this list survived with many twists and turns in the final deal. Therefore, in hindsight, the March 7, 2005 proposal proved to be more important than was thought at the time.

**March 18, 2005**

The Governor responded to the Sponsor Group by accepting its concept and, in addition, suggesting the formation of a so-called Key Issues Team (KIT) team which would involve the Governor directly in the decision making. The first meeting would take place on March 28, 2005. At the same time there would be teams to deal with the implementation of the decisions of the KIT team or to define issues for KIT team resolution, which proved useful over the succeeding months.

The State's gas team worked on a new work commitments approach as a result of extensive discussions with the Sponsor Group. The work commitments now included a provision that the fiscal stability for gas would not apply until project sanction. It still provided for the financial work commitments. It also imposed a diligence requirement that gave the State the ability to terminate the contract if the Sponsor Group was not diligent. The requirement to have first gas by 2012 was deleted and replaced by an option for the State to terminate the agreement after 12 years if there was no first gas.[10]
In early April 2005, the Gas Cabinet discussed and approved the State's opening position on 19 non-economic issues.

**April 27, 2005**

The Governor reported to the Legislature on the status of the negotiations of the three proposals (Sponsor Group, TransCanada, and AGPA). The Governor explained the

[10] DOR provided an informative presentation on ring-fencing issues with respect to the state corporate income tax. Under the State proposal fiscal stability was granted for gas but not for oil. Therefore, in case of a change in the state corporate income tax applicable to oil-related income, it was necessary to separate out ("ring fence") gas-related income.

concept of equity participation in the contract with the Sponsor Group. He explained that the TransCanada proposal also called for the State to take an equity interest in the gas pipeline company in Alaska and required the State to market its own gas. The Governor made clear, though, that such an arrangement required firm commitments from the producers.

The Governor explained that the AGPA proposal did not contemplate State equity participation. However, in order for AGPA to induce the Sponsor Group to provide gas for its proposal, the State might have to grant fiscal certainty. Also, the AGPA deal required a sales contract for the gas. He explained that the State believed that there would be problems finding necessary sites for LNG regasification plants along the West Coast of the U.S.

On May 5, 2005, the State and AGPA signed a protocol in order to work together on the AGPA project.

**May 17, 2005**

The State received a detailed letter from the Legislative Budget and Audit Committee with suggestions for toughening the proposed work commitments provisions.

**June 1, 2005**

Dr. van Meurs proposed another relatively modest step in fiscal improvements in order to get closer on a deal by fixing the royalties and concentrating on maintaining a progressive feature. However, this proposal was not accepted by all of the Departments. Therefore, the proposal was reworked based on the royalty rates in the existing lease agreements. It included a number of improvements. The main features of this proposal were:

- Lowering the State's participation share to 21%, subject to resolving capacity issues.
- Changing the 7.25% production tax after royalties to a 6.35% tax on gross production before royalties (this was about the same).
- No change in the royalties, NPS, and Point Thomson provisions from the March 7 proposal.
- Lowering the midstream property tax to 3.3 cents/MMBtu, but providing that 100% of the amount would be allocated to the municipalities.
- Adjusting the $0.50 per barrel upstream *ad valorem* oil pipeline property tax on a field by field basis similar to the Sponsor Group's proposal.
- Retaining the amount for the impact payments at $125 million.
- Adopting a simple PDP of 20% over the Chicago price and eliminating any negative payments to the Sponsor Group.
- No change in state corporate income tax.

The Governor was very supportive of this package, and endorsed it for presentation to the Sponsor Group. It was presented to the Sponsor Group the same day. However, this proposal generated internal opposition even though it had been supported by the Governor. On June 15, 2005 the State team withdrew the offer because it had not been accepted by the Sponsor Group.

**DOE receives comments on loan guaranty issues**

On May 27, 2005, the U.S. Department of Energy (DOE) asked for comments on ten issues that concerned implementation of the loan guaranty provisions of Section 16 of ANGPA. The State and eleven other parties submitted comments to DOE on July 26, 2005. Generally, the State urged that the loan guaranty program should provide incentives that would aid in the development of the project, that regulations were not necessary for the project at this time, that the loan guarantee program should not create a regulatory regime that provides an advantage to one project or sponsor over another, and that DOE should remain flexible and open to providing helpful guidance. Many of the other commenters supported the State position. After receiving the comments, DOE did not move forward on adopting regulations.

**June 2005: The TransCanada Negotiations**

Negotiations with TransCanada began in the fall of 2004 and ended with a term sheet in June 2005. The details of the TransCanada negotiations are confidential but the Governor outlined certain high level elements of the proposal in a speech to the Legislature on April 27, 2005. TransCanada contemplated that the State would take a sizeable equity ownership in the pipeline and gas treatment plant and would also take responsibility for the transportation and marketing of State owned gas. TransCanada's strategy concept provided that it and the State would strike a business deal with the North Slope gas owners to either buy their gas at the wellhead or have them make a firm transportation commitment to move their gas down the pipeline to market. As the

Governor told the legislature on April 27, 2005, TransCanada showed a "willingness" to work with the State on a tariff framework that embraced both his gas development policies and the FERC regulations. Of course, the tariffs that it proposed developing would be paid by the producers and other shippers who were not at the bargaining table. Thus, it was foreseeable that a later negotiation with the shippers would need to occur even if a deal on the pipeline itself were reached with the State. The TransCanada agreement also did not propose a package of fiscal terms for upstream gas development. This also would need to be addressed in the future. The core of the TransCanada proposal was an agreement that would facilitate development only of the midstream elements - the pipeline and GTP - but did not contemplate a fiscal contract for development of the entire project.

The State approached the TransCanada negotiations differently than the Sponsor Group negotiations. The TransCanada negotiations were conducted by a team led by DNR which was not required to obtain prior approval of the Gas Cabinet for the terms that would be offered. However, any tentative agreement they might have reached would then have been submitted to the Gas Cabinet and ultimately to the Governor for approval. With the Sponsor Group negotiations, each term of any State proposal had to be approved in advance by the Gas Cabinet. The TransCanada term sheet was never approved by the Gas Cabinet, let alone the Governor.[11]

[11] A negotiated term sheet is a precursor to a contract but it is not a contract. Substantial resources of both sides would have to have been expended to turn the term sheet in a binding contract.

**Jim Clark Becomes Lead Negotiator**

In June 2005, Jim Clark, the Governor's Chief of Staff, became the State's lead negotiator for negotiations with the Sponsor Group.

**June 28, 2005**

The Legislative Budget and Audit Committee wrote a letter to the Governor expressing concern about the fact that under the producer contract the in-service date was 2013 and under the TransCanada term sheet in the in-service date was 2012 and that the TransCanada proposal included a better work program prior to the first open season.

On the same day, the Sponsor Group provided a presentation on the term of the contract and the fiscal stability period for oil and gas which they wanted to extend to 35 years after the commencement of commercial operations of the pipeline, but not exceeding 50 years in total in the event of *Force Majeure* events.

**Summer 2005 - Negotiation of Major Issues**

In the summer of 2005, negotiations continued on nearly all issues but the bulk of negotiating time was spent on a few key issues. These key issues included how the State would acquire capacity to transport its gas off of the North Slope (capacity management), tariffs and access, work commitments, Alaska hire obligations, and fiscal issues such as the location of the royalty take point and fiscal stability concepts.

- **Alaska Hire**

With the involvement of the Commissioner of Labor, Alaska hire issues proved relatively easy to resolve. It was recognized that training to prepare Alaskans for skilled jobs in advance of project construction was critical. A commitment of both producer and State money for this purpose was identified. In addition, consistent with the requirements of the SGDA, a set of obligations to recruit and employ Alaskans where possible and to utilize Alaskan businesses that offer comparable terms were agreed upon. These are comparable to obligations imposed on other recent Alaska projects.

- **Work Commitments**

Work commitments also proved to be a contentious issue. The SGDA requires that an application for a qualified project describe a "schedule of proposed development activity," and "reflect a proposal for diligent development on the part of the applicant." SGDA § 43.82, 120 (b) (8) (A). The Sponsor Group strongly resisted the idea of a set of work commitments that imposed a schedule or tight deadlines. Before it could make a go or no go commitment to a project of such huge magnitude, it emphasized the need for specific project engineering, greater development of the project, fiscal certainty and regulatory permits and rights of way. It cited the law of large projects based on analysis from the Institute for Policy Analysis ("IPA"). IPA's work showed that projects with tight deadlines tend to suffer more severe cost overruns and engineering shortfalls or even failure.

The State insisted that enforceable work commitments had to be part of any fiscal contract. The State experimented with various approaches to a work commitments clause, including approaches with specific deadlines, *e.g.*, an open season by a specific date, project sanction by another date. As negotiations progressed on work commitments, the problem crystallized into a number of related issues that were defined by the early summer of 2005 and included the following: (i) what would be the performance standard, (ii) would there be a start date for the start of performance of the work commitments, (iii) under what conditions could work commitments be suspended (*e.g.*, during a period of a judicial challenge to the contract or during the Canadian regulatory process), (iv) whether there should be a target in-service date, (v) what would be the process for determining a failure to meet the performance standard, (vi) how would a termination proceeding be adjudicated, and (vii) what would be the consequence of a failure to meet the diligence standard (*e.g.*, contract termination), how would work commitments interact with force majeure?

Most of these issues were resolved by early August 2005. The State modified its approach to work commitments. The fiscal terms would still become effective upon project sanction, but the minimum financial work commitments were dropped. The Sponsor Group accepted that a lack of diligence would allow the contract to be terminated. The work commitment clause now included the work plan, but with dates as estimates, not as commitments. Upon termination of the contract, the State would be entitled to all data and prior engineering work.

Agreement on work commitments was finally reached in meetings with the Sponsor Group lead by the Governor in early August 2005. An enforceable, flexible and workable work commitments clause was achieved. Performance of the first phase of the work commitments had to start within 90 days of the effective date of the contract. In other words, performance of the work commitments could not be deferred until Canadian issues were resolved. A diligence standard was agreed upon - to advance the project as prudently as is reasonable in the circumstances - and that standard incorporated key elements of the prudent operator rule while it also set forth specific issues that were relevant to evaluating diligence. *See* IFIF @ 151. Within the overall dispute resolution article, specific procedures for an expedited termination process were set out. The parties agreed also that if litigation challenging the contract on constitutional grounds were brought, the project could not suspend performance on that ground and instead had to continue forward on the project for a defined period. The negotiations had moved a long way from the Sponsor Group's original strong objection to any work commitments.

- **Capacity**

Capacity management issues proved especially difficult. Because the State would receive huge quantities of both royalty and tax gas, it would need to make all arrangements for the sale of that gas. That meant that it would need to have confidence that it could obtain the necessary capacity on the pipeline to be assured that its gas could reach the market or markets where it would be sold. The State's initial objective was "derivative capacity" - it would ride the coat tails of the producers from which it was receiving royalty and tax gas. The State insisted that any capacity clause must satisfy three principles: 1) the State must be assured that State-owned gas would always be able to move off of the Slope, 2) the State's capacity obligations would need to be proportional to the producers - to the extent that they needed to acquire more capacity or were exposed to unfilled capacity, the State would acquire capacity or be exposed to unfilled capacity in a way that reflected the State's share of gas *vis-à-vis* the producer's share of gas, and 3) the producers would be required to act to acquire capacity or deal with over or underages on the State's behalf as well as their own.

The capacity negotiations were kicked off by a series of capacity workshops in the spring of 2005. The workshops provided a basis for defining the issues that had to be addressed. The producers' opening position was that the capacity issues were ones that the State had to solve without the producers' help because the State would compete with the producers in the end markets in which the gas would be sold. If the State chose to become a major gas seller, the producers thought it should embrace the responsibilities that came with that role and should not expect to piggyback on the producers. Additionally, because the producers had to act independently of each other with respect to capacity and marketing issues, they were reluctant to come up with a joint solution to the State's needs.

In rejoinder, the State emphasized that it was not a producer and therefore did not have access to producer information that enabled a producer not only to make an informed bid for capacity in the open season but also that allowed it to manage its capacity with its share of gas across different fields where it owned an interest. The State felt that if the State took its royalty gas in value, it automatically would obtain the benefit of each producer's capacity decisions. In the situation where the State was receiving royalty (and tax) gas in kind, giving the State rights to capacity derived from that of each producer's capacity situation was therefore analogous to what would otherwise exist.

Negotiation of the capacity management clause was the most extended and difficult of any clause in the contract. After the capacity management workshops, negotiations ran at one point for nearly thirty days without stopping. The Sponsor Group expended much time and energy trying to reach agreement on the terms of a capacity offer or counter-proposal to the State. One Sponsor Group negotiator said at one point that he thought it impossible to achieve what the State wanted. The State team evaluated the risks presented by capacity management proposals by vetting the proposals with experienced DNR staff and with the Lukens Energy Group.

Agreement was reached on the capacity management article, Article 10 of the fiscal contract, in the fall of 2005. Article 10 is fifteen pages long - the longest article of any clause in the contract. Its length reflects the complexity of its terms. Article 10 achieves the State's three objectives for a capacity management proposal. By its terms, at the State's request, each producer will acquire capacity in the open season for the corresponding share of State-owned capacity attributable to that producer. If there is either too much capacity or too little, the article places the State on an equal footing with the producer in acquiring or disposing of either capacity or gas so as to achieve balance.

While the Sponsor Group initially sought to have these equal footing terms kick in only after six months of disproportionality, the final version reduces that to 30 days. In addition, the capacity article contains a provision that if one or more of the producers enters into a gas balancing agreement for a property, then that producer must offer balancing terms for State gas that are the same or substantially similar to those in any such gas balancing agreement.

Because of its novelty and importance, the State and the parties anticipated seeking early approval of the capacity management article from the FERC. If the FERC does not approve of the article, the article requires the parties to negotiate in good faith for a substitute that achieves the same objectives.

- **Tariffs and Access**

The State put forward a series of proposals to address tariff and access issues. The State sought contract provisions on expansion that would supplement the FERC's new powers to order expansion of an Alaska gas pipeline. The State and Sponsor Group also identified key tariff issues that might affect access, including in-State issues. An open question during the summer was the extent to which the fiscal contract should lock in what the FERC had adopted in its open season regulations and other provisions that in the ordinary course would be dealt with in the FERC open season, application and tariff setting process.

- **Oil Fiscal Certainty**

Until mid-summer, the State had rejected the Sponsor Group position that fiscal certainty on oil was essential to any fiscal contract for the gas project. The Sponsor Group had urged that it was necessary because concessions that could be given by the State on one hand for gas could then be taken back by increased taxes on oil. Initially, the Sponsor Group even argued for 35 years of fiscal certainty for oil based on the outdated ELF-based system. Also, because gas and oil development and production were related - discovery of gas often being a product of the search for oil - it made sense to secure the fiscal base for both as part of the contract negotiations. After intense internal discussion, in August, 2005, the State decided that it would offer to provide fiscal certainty terms for oil as well as gas if the oil and gas production tax was overhauled. The State proposed a 20-year fiscal stability period for oil from the effective date. The Administration understood that the existing oil and gas production tax law that incorporated the ELF was badly out of date and was unfairly limiting State revenues from productive but older fields. At the end of August, the State announced that it would seek a new oil and gas tax law (PPT) and was prepared to give a measure of fiscal certainty on oil as well as gas as a companion to revision of the production tax law.

**August 2, 2005**

Presentations about the PPT concept as well as the proposed state corporate income tax changes were made to the Sponsor Group and to the Legislative Budget and Audit Committee. The Sponsor Group did not have a significant issue with the structure of the PPT as it was a well know international concept. However, it did not accept the new tax rates. Dr. van Meurs presented the tax on the basis of a 20% rate with a 50% uplift (this is equivalent to a 10% tax credit). However, at that time Dr. van Meurs had not yet done enough analysis to conclude that these were the appropriate percentages. He promised to do more international competitiveness analysis to verify these numbers.

Fiscal stability for oil and a new PPT represented both a major change in direction and an expansion of the terms of the negotiations. Working out the tax proposal and then securing its enactment occupied a major commitment of time and energy of the Administration for the next year.

**The August 2005 Houston Meetings**

In an effort to accelerate the negotiations, the Governor scheduled a top level meeting with the CEO's of ExxonMobil and ConocoPhillips and a top level management representative of BP in Houston in late August 2005. The State's gas negotiating team traveled to Houston with the Governor and was instructed to draft a complete contract containing a final set of the State's terms. Agreement on those terms was not reached in Houston but the parties agreed to increase their efforts to reach agreement.

**August 22, 2005**

The Port Authority presented a full proposal for a 4.5 Bcf/day project based on exporting LNG to the West Coast through a proposed LNG receiving terminal to be constructed at Kitimat, British Columbia.

**September 2005 - ConocoPhillips Breaks from the Pack**

Early in September, the State transmitted to the Sponsor Group its version of a complete and final draft of a fiscal contract.

<u>**September 2, 2005**</u>

The Sponsor Group responded to the State's PPT proposals with a document that contained blanks instead of actual numbers for a tax rate or credit rate. On the broad features there was agreement:

- The current regressive tax on gross would be replaced with a tax on net.
- A taxpayer making capital investments would receive an immediate and material tax benefit from those investments.

However, on many of the implementation details there were still major differences. The producers proposed fiscal stability that commenced retroactively on 1/1/05, and continued for the term of the contract. This would have had the effect of reversing the Tax Division's January 12, 2006 aggregation decision in Prudhoe Bay. Furthermore, the Sponsor Group's proposal for fiscal stability would have been to freeze the 1/1/05 regime in place and would provide that the new PPT rules would not become effective until project sanction. In addition the Sponsor Group proposed that oil ad valorem taxes and income taxes on oil profits also be frozen from 1/1/05 through the end of the contract term.

This proposal was followed up on September 13 with draft legislation which still contained critical blanks, but which created the PPT as a voluntary alternative for all taxpayers except for taxpayers signing a stranded gas contract, for which it would be mandatory. This proposal reflected broad agreement that a separate legislative track was needed for oil issues.

**September 8, 2005**

The State made a new fiscal proposal to the Sponsor Group. In this proposal, the State participation share was lowered to 20% and included a new progressive feature based on a charge on all non-State gas which provided for revenues for the State only when gas prices exceeded $3.50. The proposal was based on the royalty rates in the existing leases. This proposal also specifically incorporated the PPT on oil in "whatever" form that would be approved by the Legislature.

**September 12, 2005**

The Sponsor Group indicated that the September 8 proposal included some negatives and some positives. The Sponsor Group opposed any progressive feature, in particular the new progressive feature that had been presented.

**September 13, 2005**

The State made a comprehensive contract proposal including the September 8, 2005 fiscal package provisions and requested the Sponsor Group to revert with comments on September 19, 2005.

**September 15, 2005**

The Sponsor Group responded with letters to the Governor indicating that the State's comprehensive proposal was unacceptable. Instead, the Sponsor Group presented a proposal of its own that made some significant concessions and improved on its December 15, 2004 proposal. It maintained that the State's proposals exceeded the "status quo." The Sponsor Group remained dissatisfied with the State's positions on fiscal stability, fiscal structure and other matters.

Dr. van Meurs calculated the difference in State revenues between the State's September 8, 2005 proposal and the Sponsor Group's December 15, 2004 proposal, and found that the difference in State revenue take was cut in half, compared to the previous proposals.

**September 19, 2005**

The State made a new proposal to the Sponsor Group in which the progressive feature of earlier proposals was dropped and replaced with a fixed 1.5% gas in kind ("GIK"). This was a significant move. While there was reluctance to give up the progressive feature of earlier proposals, the State recognized that a problem with progressive systems for gas around the world is that it typically means that the government take goes down at low prices, but stays flat at higher prices. The new proposal was still slightly progressive because of structural reasons but not of a nature that was significant.

The Sponsor Group indicated that it was now ready to accept "royalties as they were" and would no longer insist on flat royalties.

**September 24-25, 2005**

The Sponsor Group responded again with changes in fiscal terms, leaving the State and the Sponsor Group now very close on those fiscal terms. About 80% of the difference in cash between the October 29, 2004/December 15, 2004 positions had been eliminated.

The main difference was a difference of opinion about the nature of the "status quo." The Governor had indicated that he wanted the deal to be better than the status quo. However, it was very difficult to define exactly what the revenues over the life of the contract would be with an application of the status quo rules. Review of the status quo issue led to some detailed memos on the status quo running through September 30, 2005. These levels were accepted as the new benchmarks and the State now had a more detailed definition of what it was trying to achieve.

**October 1, 2005**

Based on the analytical work on the definition of status quo, a further improvement in the fiscal terms was proposed to the Sponsor Group.

- The State went back to basics. The special 1.5% GIK percentage was dropped and other figures were recalculated to accomplish much the same effect. Also, half of an Upstream Cost Allowance was now accepted at 11.2 cents per Mcf.
- The proposal was still slightly above the State's view of the agreed status quo, but only by a narrow margin and therefore was as much as the State could offer, based on instructions of the Governor. It was presented to the Sponsor Group in this manner.

- At the same time, the State had made all the concessions it was willing to make on other non-fiscal issues as well, such as work commitments.

The Administration consulted Daniel Johnson, another international petroleum consultant, about certain key issues. In the fall of 2005, he was asked for a second opinion on the reasonableness of the financial terms of the contract. His opinion affirmed the reasonableness of those terms. Mr. Johnson later provided advice to the Legislative Budget and Audit Committee on the PPT, and most recently to the Port Authority.

**Point Thomson Resolution (October 2005)**

As noted above, the members of the Sponsor Group, and in particular ExxonMobil, insisted that development of the Point Thomson field's gas reserves were an essential step to development of a gas line. For this reason the Sponsor Group urged that Point Thomson issues be addressed in any fiscal contract. There is a long history of inadequate development plans and State responses and the matter is now in litigation. By October 2005, the Sponsor Group eventually retreated from seeking a fixed and implicitly lower royalty for Point Thomson in advance of the normal royalty determination process and the State agreed that any gas contract could include a temporary suspension of the plan of development obligation and other PTU obligations provided that certain new conditions were satisfied. These conditions included a requirement that the producers commit one-half billion cubic feet of gas to the project either by entering into a binding precedent agreement in the initial open season or by sale of a similar quantity of gas to an independent company before the open season. The producers would also be required to apply to the Alaska Oil and Gas Conservation Commission within six months of the effective date for the issuance of pool rules to authorize the offtake gas rate for PTU gas. The PTU clause ultimately proposed also spelled out a process and timetable for reinstating the obligations in the event of termination of the suspension period.

**October 6, 2005**

The Governor announced that the State had delivered a final contract to the Sponsor Group. As always, some final details remained to be worked out, in particular the so-called "offset" mechanism by which payments due to the State from the producers and payments due to the producers from the State would be offset such that all covered payment obligations of both sides would be satisfied. The State developed a concept of "Mega Payment in Lieu of Taxes" that would cover a number of items. This concept was included in the contract, and later developed into the so called "waterfall" concept, which provided a specific list of all payments that each producer must make to the State and another list of payments that the State must make to each producer. All the payments due would be summed monthly and the net resulting amount would be paid by the State or the producer, as appropriate."

**October 13, 2006**

The "final" contract was submitted to the Sponsor Group.

October 19, 2005

The Sponsor Group fleshed out its September 2, 2005 work and made its first comprehensive counter proposal on the PPT. It proposed filling in the blanks with a 12.5% PPT tax rate and credits ranging from 15% to 25%, to support, in particular, heavy oil development. That tax credits were in place of the capital investment uplifts that had been proposed by the State. In fact, the State perceived that the negotiation of tax credits might be easier than uplifts, since uplifts involve two factors in order to determine the economic effect: the uplift rate and the tax rate, whereas tax credits involve only one factor. This meant that tax credits and tax rates could be negotiated independently. The concept of tax credits was agreed.

In its other terms the Sponsor Group proposal remained the same. Now that model calculations of the proposal could be run the Sponsor Group suggested that in "year one" (i.e. the first year after project sanction) the State would take in additional revenues between $300 and $500 million – all this additional money would accrue to the State years ahead of any major gas sales or completion of the pipeline.

October 20, 2005

In a major milestone, in late October 2005, ConocoPhillips agreed to accept the State proposal on the gas terms subject to a number of conditions. If the State accepted the ConocoPhillips conditions, ConocoPhillips said that they would be prepared to declare that they had a contractual agreement with the State. The conditions were acceptable to the Governor. At about the same time, ExxonMobil and BP proposed a series of trades on long outstanding issues. ConocoPhillips did not accept the State's terms on oil and in fact argued that a deal on the gas line could be completed without oil fiscal stability provisions.

**October 21, 2005**

The Governor announced the agreement between the State and ConocoPhillips. The State and ConocoPhillips then engaged in an intensive ten-day effort to revise the contract to conform to the changes agreed to between the Governor and senior executives of ConocoPhillips. A particularly difficult issue was to create a workable "waterfall" – a mechanism to offset payments due the State from the producers (*e.g.*, pipeline *ad valorem* PILTs) and payment due the producers from the State (*e.g.*, the upstream cash allowance) are offset such that all covered payment obligations of both sides are satisfied.

On October 20, 2005, the Commissioner of Natural Resources sent a memorandum to the Attorney General, with a copy to the Governor, which raised a series of questions about whether the fiscal contract negotiations were being conducted outside the authority of the SGDA. The Governor released the memorandum to the press on October 21, 2005. The Attorney General responded to the memorandum on October 27, 2005, and advised that the negotiations were being conducted in a lawful manner and there was no personal liability for either the Commissioner or department staff as long as they continued to act within their authority as State officials. On that same day, the Commissioner of Natural Resources, the Deputy Commissioner and three other senior staff of the DNR resigned.

**October 31, 2005**

The State/ConocoPhillips contract was completed on October 31, 2005. Thereafter, the State and ConocoPhillips negotiated as a team against ExxonMobil and BP on gas issues. For the negotiation of oil issues, which had not been settled, ConocoPhillips aligned itself with BP and ExxonMobil.

**November 8, 2005**

Dr. van Meurs and Dan Dickinson developed a new presentation on the PPT that included many of the features that would be proposed to the Legislature in the next year. The proposal included a rate of 20%, a tax credit rate of 12%, and a loss carry forward that could be converted to a credit of 20%. There also was a general corporate allowance of $73 million in order to assist small companies. This presentation was given to the Sponsor Group without entering into negotiations. The State PPT team began work to put this proposal into a statutory framework. The proposed legislation did not reverse the Division's aggregation decision. In light of the (at that time) almost unprecedented high oil prices it did not delay the implementation date of this progressive tax for several years until project sanction.

**November 11, 2005**

The State and ConocoPhillips presented their joint contract draft to BP and ExxonMobil. In the prior week, BP and ExxonMobil presented proposed trade sheets on at least 19 articles and Exhibits. These were offered as a package deal in a form that would give the State essentially its positions on specified issues if the State would agree to their positions on other issues.

**November 18, 2005**

BP and ExxonMobil were notified that the State was prepared to start negotiating fiscal stability on oil on November 28, 2005 (this meant negotiating the PPT) provided that BP and ExxonMobil first agreed to finalize the gas contract. The State identified the following as important outstanding items: fiscal terms, voluntary expansion, dispute resolution, new leases and creation of a model upstream contract.[12]

**November 30, 2005**

A new presentation was made to the Sponsor Group on the PPT. This included the same features as before, except that the tax credit was now 15% (as originally had been intended) and a proposed 35% credit on the GTP.

**Agreement on Gas Fiscal Terms**

The week of November 28, 2005, was a decisive turning point in the overall negotiations. At the beginning of the week the Governor visited ExxonMobil's CEO and top executives of the other two companies in Texas to secure agreement to the fiscal terms that ConocoPhillips had already accepted. A frank exchange of views resulted but no agreement reached. However, by Friday, December 1, 2005, BP and ExxonMobil accepted the State's core gas fiscal terms and, at a high level, a package of terms for an

[12] The Sponsor Group wanted to be able to acquire new leases and add them to the core list of leases covered by the fiscal contract. The added leases then would receive the benefits of the fiscal contract. This might give the Sponsor Group companies a benefit in bidding against independents for new leases. The solution was to develop a model upstream contract that, if authorized by the Legislature, would extend the benefits of its fiscal contract to any producer who would commit gas to the project. The Sponsor Group companies could then add leases to the fiscal contract once the new law was enacted.

oil PPT that neither company would oppose. They now accepted 20% State participation in the gas line and GTP as well as a 7.25% flat production tax. The oil terms, if enacted, were projected to increase State revenues by one billion dollars at then-current prices. A by-product of that agreement on fiscal terms was an agreement that the State would indemnify the carriers if the RCA took action with respect to the gas line that was inconsistent with federal principles. In return, ExxonMobil and BP agreed to the concept of expansion provisions that the State could unilaterally trigger.

**December 1, 2005**

Even though there was high level agreement on gas fiscal terms and on very basic terms of an oil tax increase, much work remained. The language of the State/ConocoPhillips October 31, 2005 contract had not been accepted by ExxonMobil and BP. Thus, it was necessary to reach agreement on the final text of the fiscal contract for gas. An even larger assignment was to reach agreement on the substance and language of legislation for the PPT and then expand the contract to include fiscal certainty and related terms for oil. As it turned out, negotiations to complete the fiscal contract for gas took until the end of February 2006. Completing the contract for all oil-related issues, particularly the PPT, required additional time and was finally accomplished on May 24. 2006.

**December 15, 2005**

Jim Clark notified the Sponsor Group that:

- The State would not agree to royalty disputes being brought under the dispute resolution clause.
- The recoupment provisions affecting the State's gas could not impair the State's financing of its share of the project's costs.
- Voluntary expansion provisions would be required in the contract.
- Some still outstanding capacity issues would need to be resolved.
- A North Slope-wide field cost allowance would not be acceptable.
- BP and ExxonMobil should be ready to negotiate the PPT when Dr. van Meurs was in town.
- The State and the Sponsor Group would need to reach agreement on gas issues first before the State would be prepared to finalize the PPT.

**January 18, 2006 - PPT**

While details were not nailed down in a specific legislative proposal, the State made its first PPT presentation to the Senate and House Resources Committees. The twin objectives of the PPT were to encourage investment in the State and, at high prices, to generate more revenues than the existing ELF based system. The international framework of the PPT was also discussed.

**January to February 21, 2006: Agreement on Gas Contract Reached**

The parties resumed negotiations on the gas contract after the holiday break at the end of 2005. BP and ExxonMobil had not accepted *per se* the State/ConocoPhillips joint contract even though agreement had been reached on the core economic terms in early December. There were a substantial number of differences that had to be resolved.

For example the dimensions and operation of the waterfall of potential payments between the State and the Sponsor Group required much negotiation. The State wanted to ensure that it would be able to service gas pipeline-related debt from the revenues it expected to receive from the pipeline, which meant that debt service could not be "subordinated" to any waterfall payment obligations otherwise payable to the producers. Protection for debt service payments was ultimately agreed upon.

Other major issues which were resolved in the first months of 2006 included the scope and operation of the fiscal stability clause, the treatment of impurities at the gas treatment plant, State-initiated expansion rights, the relationship between the contract and municipal taxes and audit and accounting procedures. All of the gas-related issues were closed out on February 18, 2006.

During the week of February 20th, high level management teams from the three producers met with the Governor and the Gas Cabinet in Anchorage. At these meetings, the gas deal was confirmed[13]. As set forth below, this meeting also resulted in broad agreements on the principles and rates that would appear in a reformed oil production tax.

From this point on the negotiation's main focus shifted to oil fiscal stability.

[13] Over the next two and one half months, the drafting teams perfected the gas contract by working on many technical corrections, finalizing a number of the exhibits, and working out a small set of oil and tax related provisions such as the articles dealing with ad valorem taxes and the incorporation of the PPT. The LLC negotiations, which were being conducted by a separate team, also continued.

**The PPT Advances**

To recap the PPT story up to this point, in the summer of 2005 the State had agreed to fiscal stability on oil production taxes provided they were reformed and modernized. While there was broad agreement with the Sponsor Group that that meant a tax on net (rather than gross as was then the law) and credits for capital investments and exploration, the details had not been agreed. The state had made several proposals, while the producers stuck by their October response. In the early winter of 2005 -2006, Dan Dickinson, Rob Mintz and Dr. van Meurs completed a first draft of the PPT legislation.

**February 1, 2006**

A presentation on the PPT was made to the Senate and House Finance Committee. The possibility for higher credits for heavy oil was left open.

**February 5, 2006**

The Sponsor Group provided the State with a high quality overview of the economics of heavy oil production. This permitted Dr. van Meurs to analyze heavy oil issues in much more detail than he had done before and, in particular, investigate the possibility for higher tax credits.

Dr. van Meurs came to the conclusion that the high costs of heavy oil would also mean very high tax credits for the State and that the State could simply not be exposed to these risks under low oil price conditions. Therefore, he could not recommend higher tax credits for heavy oils. He presented his findings to the Sponsor Group on February 7, 2006.

Dr. van Meurs discussed with the Legislative Budget and Audit Committee consultants the possibility that he could support a tax rate of 25% and a credit of 20%. They felt that this could be amply supported by international evidence. They requested that he do some additional analysis, and on February 10, 2005, Dr. van Meurs told the Legislative Budget and Audit Committee that he would defend a 25% tax rate and a 20% credit. Dr. van Meurs informed the Governor of the fact that the consultants and he were now in agreement with respect to 25-20.

**February 18, 2006**

Dr. van Meurs delivered to Bill Corbus a final report on the PPT with the recommendation for the 25-20 PPT rates.

**February 21, 2006**

As recounted above, on February 20-21, 2006, high level meetings were held between the producers and the Governor and the Gas Cabinet. The Governor advised the companies that if they could not come to an agreement on a PPT framework, then he was prepared to introduce legislation that would incorporate the 20% credit and the 25% tax rate as recommended by Dr. van Meurs. Faced with that possibility, the parties agreed to a "common vision" of the production tax which came to be called the "20/20" proposal reflecting a 20% tax rate and 20% investment credit. The parties also agreed that a bill would be submitted to the Legislature, but that the terms of the legislation would also be reduced to contract language. The Governor presented the breakthrough in a press conference the following day. Major terms were:

- A tax rate of 20% on the net.
- A 20% credit rate for investments or losses.
- $73 million dollar "corporate allowance" or "standard deduction".
- Investments made in 2001 – 2005 could also be treated as credits for the first seven years of the PPT.
- 35% credit for the GTP investment (though this was not included in the legislation)
- Effective date of July 1 2006.

**February 23, 2006**

Commissioner Corbus led a DOR team that presented the Governor's bill to the House and Senate Resources committees and worked with individual legislators. DNR also testified in favor of the bill. In that presentation the higher rates in the PPT were expressly tied to the concept of fiscal stability which was embedded in the stranded gas contract. Unfortunately -- and certainly not anticipated by the PPT team -- the release of the contractual oil fiscal stability terms was still three months into the future. The committees focused a great deal on the unknown of how the contract and PPT legislation would interact.

**February 27 and 28, 2006**

The producers testified before the Legislature, confirming that this was simply a piece of the overall gasline project. With relative degrees of reluctance, the Sponsor Group members testified in favor of a 20-20 rate proposal.

**March 2006**

Simultaneously with legislative committee work, the negotiating teams struggled to reduce the language of the proposed PPT legislation to contract terms, and to incorporate dispute resolution and administrative procedures pertinent to oil in the contract. This process encountered a moving target as both Senate and House Resource Committees passed amendments or committee substitutes considerably reshaping the legislation. By mid month the committee substitutes moved to the respective finance committees of each body. Again the State teams testified repeatedly as well as worked with individual legislators addressing their concerns. The Legislature's experts also testified on oil issues, and by the end of the month yet another set of potential amendments were emerging, thereby making contract language difficult to nail down.

In addition income tax on oil related income and ad valorem taxes on oil pipelines continued to be discussed. Not unlikely the moving PPT target, the ad valorem discussion was dominated by the January 1 2006 assessment and attempts to resolve the shorter term issue of open appeals on that matter.

**April 2006**

The finance committees of each body held extensive hearings on the PPT legislation, and the DOR team responded with extensive testimony, both written and oral. The contract writing team now aimed for an end-of-the-session strategy, and resolved to initially incorporate the language of the Governor's original PPT bill in the contract. The thought was that after the contract was finally made public for the May 10, 2006, special session, the Legislature would no doubt insist that the oil language conform to whatever bill it had passed. Nonetheless the negotiations on even the original PPT language proved as slow going as the other oil and gas terms that were being finalized.

**May 10, 2006**

The teams succeeded in finalizing a contract that resolved all gas and oil issues except for the PPT. For the other oil Payments in Lieu of Taxes this involved building in shorter contract terms, though mechanisms were left in place so that if the contractual terms were working the parties could opt to retain them, and not revert to the replaced tax. That contract was released to the public on that date along with a preliminary fiscal interest finding analyzing the terms of the proposed contract.

**May 24, 2006**

The parties agreed upon and released a fiscal contract that included approximately 100 pages of additional exhibits and a clause relating to the proposed PPT. That contract included approximately 100 pages of additional exhibits and clauses relating to the proposed PPT and a commitment allowance that replaced the GTP credit.

**May – June, 2006**

The Legislature failed to pass the PPT bill in the regular session. It passed the House, but failed by one vote in the Senate. It appears that the failure to pass PPT was due to a non related dispute among the Senate majority. Failure to pass the PPT in the regular session made passage of the PPT the central issue of the two special sessions that followed. This prevented legislative focus on the SGDA legislative amendments which were a prerequisite of legislative ratification.

The basic gas fiscal contract between the State and the Sponsor Group was submitted to the Legislature on May 10, at the start of the special session. However, the terms relating to oil were not included. It took two more weeks to negotiate that language. Because the contract was intended to become comprehensive and complete with respect to the Sponsor Group's fiscal obligations to the State, it was necessary to bring into the contract complete procedures for administering the payments in lieu of taxes. To do this, the parties attempted to incorporate much of the existing body of DOR regulations into the contract. Finally, on May 24, 2006 a fiscal contract that included a PILT reflecting the proposed PPT was released.

**July – August 2006**

In early June as the special session ran out its allotted thirty days, the Legislature again declined to pass PPT legislation. However, in the closing hours of the session when it appeared that a bill with limits on the use of Transition Investment Expenditures (that is the right to use certain investments made between 2001 and 2005 as credits), a tax rate above 20% and a progressivity factor might pass the Legislature, the Sponsor Group attempted to reopen contract negotiations. It argued that the deal struck in February would require other adjustments in the contract to equalize the more aggressive stance adopted by the Legislature with respect to the PPT. The State responded that the gas terms were finalized and that the Legislature had spoken on oil, so no renegotiation was needed. For much of the summer that State and the Sponsor Group negotiated about negotiating about the PPT in the contract.

In July the Governor called another special session and again he introduced a PPT bill, along with legislation required to implement the contract. In this special session the PPT legislation passed.

In addition, during the special session a Special Committee on Natural Gas Development of the Senate chaired by Ralph Seekins held several hearings to consider various proposed amendments to the contract. A dozen or so amendments were individually discussed and favorably voted on, but when it came time to vote on the amendments as one complete package, the members of the Special Committee did not approve the package. Individual elements of the package included, for example, a shortened period of overall fiscal certainty and differing terms of fiscal certainty for oil and gas, a work commitments clause with a letter of credit forfeiture concept, and restrictions on arbitration. The Special Committee then adjourned without having adopted any amendments to the SGDA that would have required changes in the contract.

Approval of the contract did not advance within the Legislature, and within weeks the Sponsor Group withdrew from even negotiating about negotiations. Instead, the State developed its own post- negotiation amendments to the contract, including an amendment that left to a future date determination of the final contractual PPT language to appear in the contract. However the goal of such language, the State suggested, would be to create a PILT that would replicate the PPT as it would exist at that time.

As passed HB 3001 included the following features:

- 22.5% tax rate, with a higher progressivity surcharge for Production Tax Values above $40 a barrel.
- 20% credits for investment and exploration.
- $12 million annual credit replacing the "corporate allowance", however it was limited to taxpayers producing fewer than 50,000 bbls a day, thus no member of the Sponsor Group would qualify.
- The ability to use 2001-2005 investments for credits is tied to the taxpayer making additional investments prior to 2013.
- Effective date of April 1, 2006.