

**DEFICIENCIES IN THE JANUARY 26 DRAFT  
OF THE STRANDED GAS CONTRACT**

**February 1, 2006  
Pedro van Meurs**

Dear Jim,

You asked me to help today at 8.45 am with section 9A. I gladly do so. However, I do not want this help to be confused with my recommendations in this regard.

I have related to you orally since November last year that there are three main deficiencies in the draft package at this time in my view. We have not been able to do a joint thorough read-through of the agreement. So I do not know whether there are possible other deficiencies. In any case I like to comment on the issues that I am aware of in order to clarify my views.

**Fiscal stability.** I believe we have gone completely over board on fiscal stability. I strongly believe that we need adequate fiscal stability to encourage the investment in the pipeline. Nevertheless, there is no need for the near absolute fiscal stability that the agreement now contains. This is a degree of fiscal stability that is normally reserved for highly corrupt and completely unreliable states.

Despite the boisterous politics of Alaska, the State has never adjusted fiscal terms to the producers in a way that is unreasonable compared to international practices in developed nations. On balance, the State of Alaska has been a reliable business partner with respect for law and with a well functioning democratic system. There is absolutely no need to treat Alaska as a banana republic in order to secure the gas line.

I believe that the concept of "capping" municipal taxes of general application is totally unnecessary. Any reasonable evaluation of the municipal taxes in Alaska clearly indicates that the margin that municipalities have to create taxes of general application is limited. The impact of variations in municipal taxes of general application on the project economics is negligible. Therefore, in my opinion municipalities should be free to tax as they wish and the Participants should pay these taxes without limit.

The only fiscal stability required under the Contract would be a prohibition for replacements of the taxes that are dealt with in the agreement, similar taxes and targeted taxes. All other taxes should be paid. This would be a very high level of fiscal stability that is more than adequate to underpin the economics of the project.

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**Recoupment from gas in kind.** Section 9A includes a provision to recoup possible outstanding payment requirements by the State from gas in kind. This provision is totally unnecessary and highly damaging to the interests of the State.

To begin with, the risk that the State would not pay an outstanding bill is extremely low. However, this risk can be adequately dealt with by introducing a simple carry forward provision as is done in most international contracts. Outstanding obligations of the State can be carried forward to next year with interest and offset from future cash payments. Interest can even be made onerous in order to protect the Participants. The risk that the cumulative State obligations to the Participants would exceed the cumulative corporate income tax payment requirements to the State is nil. Therefore, there is absolutely no need to affect the State's gas in kind.

The current provisions in 9A now seriously undermine the entire economic concept of the Contract. The concept was that the State would considerably improve project economics by directly participating in the project. By taking gas in kind and making the required shipping commitments and assuming the marketing obligations, the State improves the economics considerably. However, this economic concept is based on the fact that the State should have a reasonable opportunity to market its gas.

The provisions of 9A considerably undermine this ability. In order to solve a non-problem to the Participants, the State has now seriously undermined the credibility of a possible State gas marketing organization. The economic concept on which the Contract was based is now no longer viable in my view.

The recoupment provision from gas in kind has nothing to do with fiscal stability.

I believe that any notion of recoupment from the State's gas in kind should be eliminated from the Contract.

**Parent Company Guarantee.** The early drafts of the State proposal included a Parent Company Guarantee in order to guarantee the implementation of the Contract by the producers, the LLC's in Alaska and the lower 48 States and LP's in Canada. A Contract between Alaska producers and the State of Alaska cannot be implemented in Canada or Lower 48's unless the parent companies commit to do so.

We proposed to the Sponsors to come back on this issue when the so-called "coordination agreement" would be discussed. However, since that time there has been zero progress on this agreement.

Without a parent company guarantee the Contract is not worth the paper it is written on. Companies can simply escape the work commitments and participation rights of the State because the Alaska LLC's or Alaska producers have no control over the Canadian LP's or Lower 48 LLC's.

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I am deeply concerned about your statements that you hope to "finalize the agreement" soon. I believe that it would be a fundamental error to finalize the agreement without the resolution of this matter.

It is now clear that the "coordination agreement" is in never-never land. Therefore, the best way to protect the interests of the State in this respect is to have the parent company guarantee in the Contract. I believe that this should now be absolutely insisted upon.

Best regards,

Pedro

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