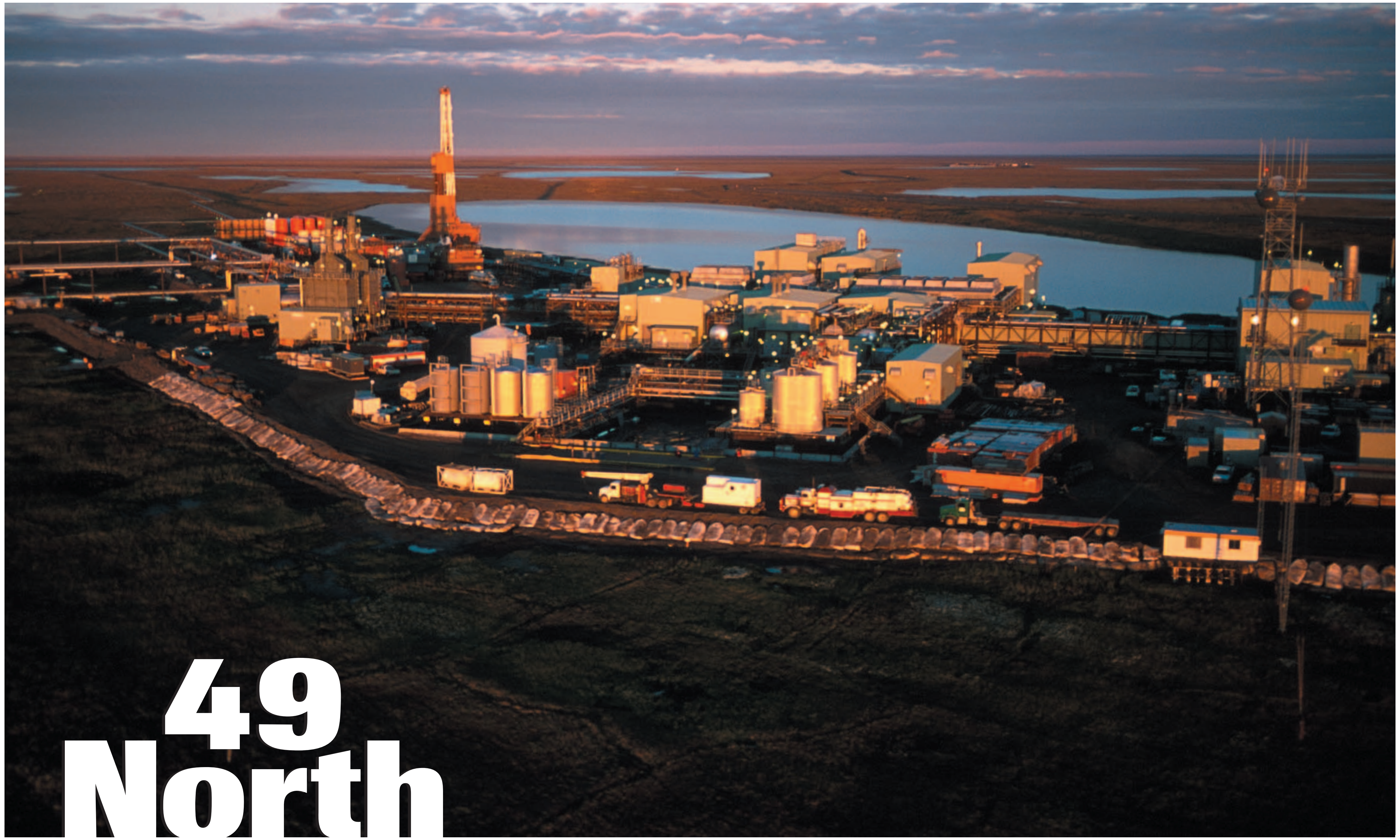


49 North

Facilities at the Alpine field. Photo, courtesy of Phillips Petroleum.

BY DAVE HARBOUR

OPINION

A tale of two pipelines - Americans and Canadians both want a northern natural gas pipeline. Will they risk a long-standing friendship to get it?

As the Mackenzie Valley pipeline moves closer to reality, the Alaska project seems bogged down. Canadian federal and local governments generally support the efforts of potential pipeline investors while Alaska's government boldly attempts to dictate the efforts of potential pipeline investors.

In the 1970s, pipeline proponent Arctic Gas had an efficient concept, proposing to transport Prudhoe Bay gas with Mackenzie Delta gas through a pipeline running along the north coast to the Delta and then up the Mackenzie Valley. Today, this is known as the 'northern route' and it has promoters but no leading champion.

Mackenzie Delta producers are developing a project to transport Canadian gas reserves through the Mackenzie Valley standalone pipeline. After completing a feasibility study last year, they are now working on the project definition and environmental assessment with an eye to filing a regulatory application late in 2003. They have started a series of community consultations, beginning with the Sahtu inMarch and the Deh Cho in May. In mid-May, the conceptual and preliminary engineering contract was awarded to ColtKBR, a partnership of Colt Engineering and Kellogg, Brown Root.

The Mackenzie Valley Aboriginal Pipeline Corporation, representing aboriginal interests, will own up to one-third of this pipeline. Working together, several regulatory agencies and boards, including the Mackenzie Valley Environmental Review Board and the National Energy Board, have developed a draft 'Cooperation Plan' for coordinating regulatory reviews of pipelines at all levels of government.

This project could be delayed by the efforts of Arctic Resources Corporation of Houston and its Canadian subsidiaries, ArctiGas Resources and the Northern Route Gas Pipeline Corporation. Arctic Resources proposes the northern route, now banned by Alaska law and voted against in the U.S. Senate and House of Representatives.

Arctic Resources proposes a 100-percent debt-financed, 100-percent aboriginal-owned, risk-free project using municipal bonds in the U.S. and non-recourse revenue bonds in Canada. A free lunch concept is compelling, but it has no significant support from Alaska, the North Slope municipal government, producers, shippers, pipeline companies, Congress or other Canadian aboriginal interests. Any light at the end of Arctic Resources' tunnel lies in cooperation with these parties, not in confrontation. Its own 'community consultation' activity could, however, result in rights-of-way agreements or confusion among parties that could cause delay.

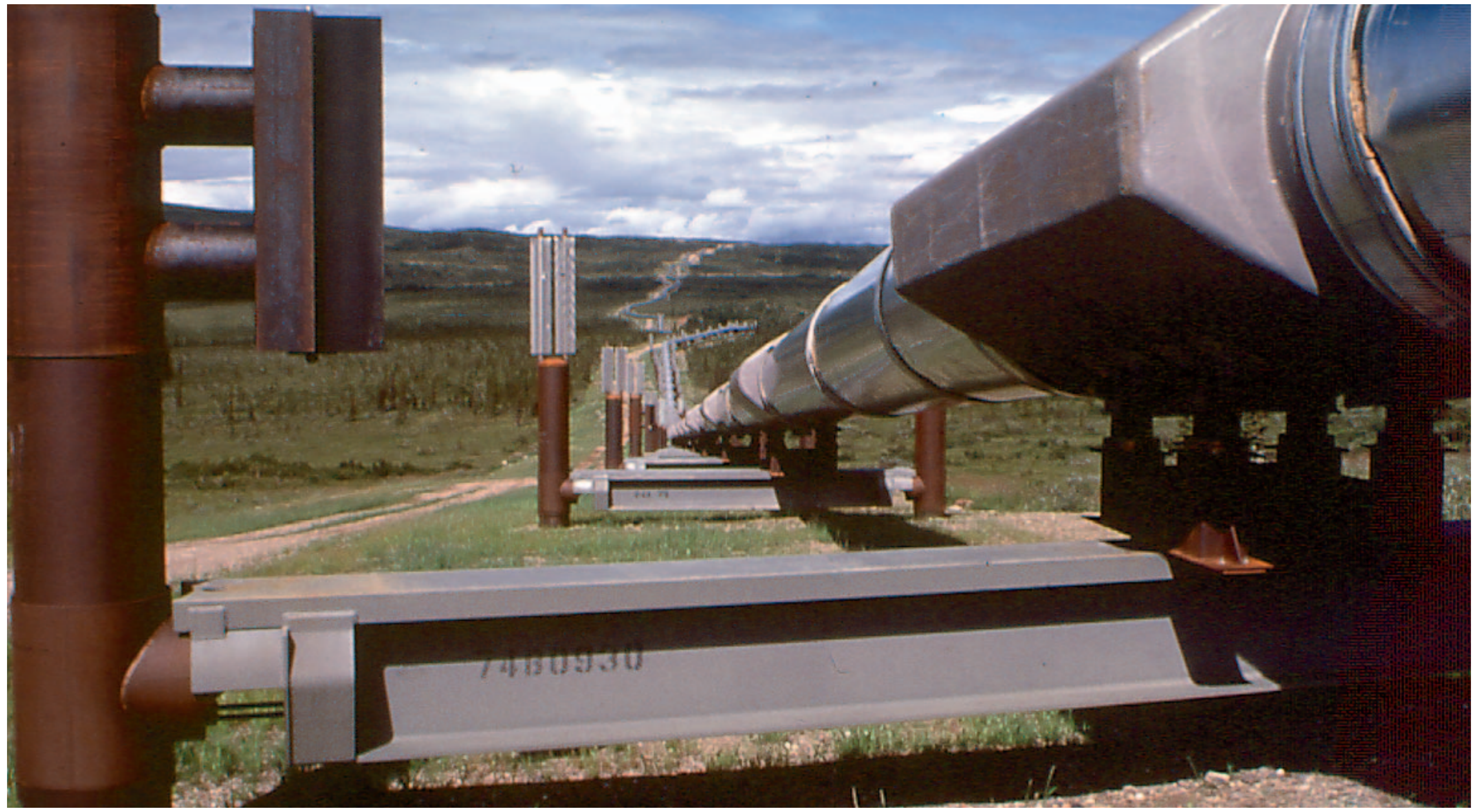
The Mackenzie Valley pipeline could be the first Arctic gas project if it progresses without significant delay. It would have the best access to available steel-making capacity, construction labour, and the opportunity to train aboriginal workers. It could provide natural gas required for Fort McMurray's oil sands expansion, replace declining Canadian reserves and stimulate new Arctic exploration. Completed first, and used to satisfy Canadian demand, it would have little adverse economic effect on future Alaska pipeline development.

The Alaska Highway project, called the southern route, would cost more than 6 times that of the Mackenzie Valley project, based on the latest estimates by the Alaska gas producers that peg the northern route at U.S.$18.6 billion and the southern route at $19.4 billion. Its huge throughput, at between 4 - 6 billion cubic feet per day, would satisfy much U.S. market growth and help make up for declining continental natural gas production. Some Alaskan gas could be used in Alberta's oil sands and petrochemical developments. And with the Alaska Highway pipeline in place first, a future option to move combined Arctic reserves could be pre-empted.

Without Alaska and U.S. government action, it now looks less likely that the Highway project will be first. Alaskan politicians know more about the art of attracting votes than the science of creating natural resource wealth, and have embarked on a course that is destined to delay the project.

Alaskan producers, expected to be major investors in a pipeline project, have established four reasonable and unchallenged criteria. The first one stipulates that the project should be commercially viable. Alaska producers say neither project is viable today, but increased demand, decreased production and long-term price stability could change that outlook soon.

Secondly, the U.S. government should enact regulatory-enabling legislation. The Senate has included required enabling language in its energy bill. But congressional action is not assured since there is growing opposition to other provisions in the energy bill. These include House and Senate bill versions prohibiting the northern route as advocated by Alaska's delegation, though the U.S. and Canadian



The Alyeska Pipeline. Photo courtesy of Phillips Petroleum.

federal governments are route neutral. The Senate bill proposes a $10 billion loan guarantee and a guaranteed price floor for Alaska gas, moves designed to jumpstart the feasibility of the southern route.

We polled five leading North American economists for this article. All opposed government manipulation of the free market prohibiting competitive pipeline routes or giving incentives to others. Said one: "The political shenanigans of Alaskan politicians have increased the political risk profile to unsavoury heights for Alaskan gas project developers. These are unfortunate developments not worthy of North American democracies."

Members from each house of Congress, meeting in conference, could resolve the House and Senate differences possibly by fall. An energy bill could fail in 2002 or pass without the desired provisions, effectively delaying an Alaska project for at least another year. Further, Alaska's failure to provide meaningful gas pipeline project support legislation in 2002 will not impress conferees.

Thirdly, Alaska should provide the project with fiscal certainty, which it failed to do in the 2002 legislative session ending in May. Such certainty could take the form of a responsible, long-term state fiscal plan and an agreement between the state and producers identifying tax and royalty valuation methodology. Multi-billion dollar Alaska project investors would be right to fear that a state in dire financial straits might solve its problems with arbitrary and predatory taxes affecting pipeline economics. Alaska spends $1 billion more than it takes in annually, funding the difference from savings accounts that could be depleted by late 2004.

Finally, Canada should provide regulatory process certainty and clearly define aboriginal interests. Although a draft 'Cooperation Plan' has been developed, the several agencies and boards involved make even this model effort look cumbersome. Recent court decisions regarding First Nations' interests also pose challenges.

In today's political environment, one questions whether there is a role for Arctic Resources' northern route. Even if Canadian and U.S. administrations weighed in and kept the route available, Arctic Resources' ownership and financing model has not attracted critical parties to the table. The Mackenzie Valley project could be expanded to accommodate Alaskan gas without Arctic Resources' involvement. If they wish to continue to oppose other projects and possibly create a 'franchise' by tying up profitable rights-of-way, they could endanger the chance for the Mackenzie Valley line to be first.

Having prohibited the northern route, Alaska's best chance for getting the southern route is to have it supported by government as described above. Since it did not pass legislation creating fiscal certainty this spring, Alaska could call a special legislative session to deal with pipeline tax, royalty valuation certainty and state budget planning. Without it, they delay the project by the year it takes a new legislature to act. If Congress doesn't act on southern route incentives, the project is delayed.

The American government is making it difficult for Canada to support transit of Alaskan gas via any project by undertaking pipeline routing mandates, pipeline incentives and punitive Canadian trade policies without seeking the advice or consent of Canada. America's State, Commerce and Energy Departments should exercise better cooperative communication with their largest trading partner peers.

Citizens and governments must understand that their control over natural resources in a free market is limited. Public control rests on the laws and regulatory regimes designed to accommodate the public interest. Petroleum producers and investors should make unfettered decisions based on prevailing law and regulatory regimes. Otherwise, we evolve into other than a free market system.