

Testimony of

Mr. David Boies

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Mr. Chairman, Members of the Committee, thank you for the opportunity to address the Committee on the important issues of rising energy prices and consolidation in the oil and gas industry. In particular, I would like to address certain anticompetitive practices in the oil and gas industry, the rising price of natural gas, and potential improvements in the antitrust laws to address these issues.

Introduction

As this Committee is well aware, for the last several years the price of natural gas has risen steadily and sharply. This trend significantly burdens the U.S. economy and the average American. As millions of people struggle to meet the rising energy costs, vast amounts of natural gas sit idle beneath Alaska's North Slope. The reason those resources have stayed in Alaska and have not been brought to market is that ExxonMobil and BP, the companies that control the production of most of those resources, have decided between themselves that they would prefer to withhold this gas and maintain artificially high natural gas prices throughout the U.S., rather than market North Slope natural gas. Our client, the Alaska Gasline Port Authority, has brought an antitrust lawsuit challenging those practices. My testimony here today is not to argue that lawsuit, but to examine the behavior of those producers and the market structure to assist this Committee in determining whether any revision to the antitrust laws is necessary.

The Rising Cost of Natural Gas

The U.S. Department of Energy estimates that the U.S. average consumer price for natural gas for the winter of 2005-2006 increased 22.7% over last winter. Large and steady increases in natural gas prices are not new. Prices increased 13.1% in the winter of 2004-2005 and have risen by more than 150% over the last six years. Despite the moderating effect the most recent mild winter has had on natural gas prices, they are not expected to decline in the future.

Of course, the most vulnerable among us are the most affected by the rising prices. Millions of low income families need financial help to pay their energy bills. Millions more forgo other basic necessities to keep their utility service turned on.

ExxonMobil and BP's Control of Alaska's North Slope Natural Gas

In a competitive market, the steady climb in natural gas prices would have induced the producers to increase their efforts to bring more gas into the market with the result of increasing supply and reducing prices. However, the natural forces of competition do not appear to be working on Alaska's North Slope, where the largest owners and developers of natural gas on the North Slope of Alaska, ExxonMobil Corporation and BP p.l.c., have jointly prevented North Slope natural gas from being brought to market.

The natural gas resources lying beneath the North Slope of Alaska are immense. Conservative estimates of proven natural gas on the North Slope exceed 35 trillion cubic feet (TCF). That gas in these quantities exists has been well known for over 30 years now. Some authorities estimate there are additional undiscovered gas resources in Alaska exceeding 150 TCF. By comparison, the total amount of natural gas consumed in the entire United States last year was approximately 22 TCF.

Ninety-four percent of the proven natural gas resources on the North Slope are owned by only three companies. Two of them, ExxonMobil and BP, together own 67% of those resources. Collectively they own over 60% of the natural gas resources in the Prudhoe Bay Unit ("PBU"), and over 75% of the working interests in the Point Thomson Unit ("PTU"). Their control over Alaska natural gas is further increased by unit operating agreements and ancillary agreements, many secret, that limit the production and development of lease interests in the PBU and PTU. For example, certain agreements effectively require both ExxonMobil and BP to agree before either markets natural gas from the PBU (other than for limited on-site use). Moreover, BP is the unit operator for the PBU and ExxonMobil is the

unit operator for the PTU. Thus, ExxonMobil and BP together control the development of almost all the gas resources that they do not own.

ExxonMobil and BP's Anticompetitive Behavior

Our complaint alleges that ExxonMobil and BP have used a variety of illegal means to maintain a stranglehold on the supply of natural gas on the North Slope and prevent it from ever reaching a market. They have acted together with the purpose of eliminating competition that could threaten their control over the development, marketing and pricing of natural gas.

For years they have refused to market North Slope natural gas. For example, natural gas is extracted every day on the North Slope as a by-product of the oil production process, but instead of being sold, it is re-injected into the ground. On the PBU, natural gas amounting to approximately eight billion cubic feet per day is extracted in connection with oil production. A small quantity is used for local operations and the rest is put back into the ground. No natural gas ever makes it off the North Slope. While re-injecting natural gas has the benefit in certain situations of increasing field pressure, it is not useful for this purpose in certain situations and there are virtually always more cost-effective approaches than abandoning the development of Alaska's immense natural gas resources.

ExxonMobil and BP's actions with regard to the PTU are even more egregious. For over 25 years, ExxonMobil and BP have ignored their duty to develop their leases and have failed to produce any gas or oil from the PTU.

In addition, ExxonMobil and BP have also engaged in a concerted effort to derail any gas pipeline that could be used to transport gas from the North Slope to domestic markets in the U.S. and elsewhere. ExxonMobil and BP know that without their commitment to supply a pipeline with gas, no pipeline sponsor will receive the financing to build a pipeline. As ExxonMobil's former CEO Lee Raymond stated:

Then you have these competing pipeline proposals, which is fine if that's what you want to do. But the reality is, nobody is going to build a pipeline without the producers. You and I know how pipelines get built. The pipeline goes to the bank. The guy at the bank says, what are you going to put in your pipeline? Gas. Do you own the gas? No, I don't own the gas. Well, who does own the gas, and do you have a commitment from them that they are going to put it through the pipeline? Well, no, we don't have that. Then I don't think I'm going to give you much money to build a pipeline.

For several years the Alaska Gasline Port Authority has attempted to negotiate with ExxonMobil and BP for the purchase of natural gas. The Authority has secured significant senior permits, engineering studies, cost estimates and plans to build a natural gas pipeline. It also has \$18 billion in loan guarantees available to it. Indeed, the Port Authority's pipeline could supply 7%-10% of the total amount of natural gas used in the U.S. today. And with the amount of gas on the North Slope, it could provide that supply for decades. The only obstacle to the project is the producers' commitment to supply gas from the North Slope. Despite AGPA requests, ExxonMobil and BP have refused to engage in any discussion of the price or terms for the sale of North Slope gas.

ExxonMobil and BP's refusals to deal on the North Slope are not new. Over the years they have also jointly derailed projects proposed by other well-qualified pipeline sponsors such as Yukon Pacific Corporation, Warren Buffett's MidAmerican Energy Holdings Company, and TransCanada.

ExxonMobil and BP's refusals to deal run directly counter to their duties as leaseholders. BP has also violated the Charter BP entered into with the State of Alaska as a condition of its merger with Atlantic Richfield Co. In that Charter, BP agreed to negotiate in good faith with third parties for the sale of natural gas.

The result of ExxonMobil and BP's illegal conduct has been to artificially restrict the supply of natural gas and thereby artificially inflate the price of natural gas both in the U.S. and elsewhere.

ExxonMobil and BP's refusals to deal on the North Slope are a part of a pattern of manipulating and constricting supply in order to raise prices and increase their control of oil and gas markets. For example, in the mid-1990s, BP sold oil from Alaska in Asia at prices lower than it could have gotten in the U.S. in order to tighten U.S. oil supplies and raise the price of oil shipped to refineries on the West Coast. This scheme was set out in an e-mail exchange between two BP employees, in which they discussed "shorting" the West Coast market to achieve West Coast "price uplift scenarios." One of these employees called the plan a "no-brainer." BP's conduct resulted in high prices at the pump for gasoline across the West Coast.

In addition to foiling all efforts by others to transport natural gas off the North Slope, ExxonMobil and BP have been stalling for years on coming to terms with the State on a pipeline deal. Now, mere months after we filed our lawsuit, ExxonMobil and BP claim to have reached a deal with the State. The terms of that deal have not been publicly disclosed, but we understand that it only sets out a timeline for continued study and negotiation. In other words, ExxonMobil and BP have not committed to construction of a pipeline, they have just agreed to continue to study and negotiate. Therefore, ExxonMobil and BP remain in control of the timing of any pipeline construction. This provides them with complete control over determining when North Slope natural gas finally comes to market, and permits them to extend the period of artificially high prices. Further, it is not certain that they will ever construct a pipeline. Any

agreement by ExxonMobil and BP regarding marketing of North Slope gas must be viewed in light of their ongoing failure to live up to their earlier agreements under their leases to develop this critical resource.

The Legal Issues Presented by the Restriction on Output

With this background, let me turn more specifically to the issues the Committee is studying. As this Committee knows, proving collusion can be a lengthy, difficult, expensive and uncertain endeavor. Sometimes evidence of collusion is available. In the Vitamins Antitrust Litigation, for example, we were able to prove that the vitamin suppliers got together in a room and agreed to reduce output to the U.S. markets. But proof of collusion is difficult to find and often anticompetitive cartels are never exposed to the light of day.

These problems can be particularly pronounced in the oil and gas industry. Generally speaking, it is safe to assume little good can come from situations where competitors sit down together and discuss prices or output. The mere opportunity to collude raises red flags. There are so many joint operations in the oil and gas business -- many of which apparently have received no antitrust scrutiny through the Hart-Scott-Rodino process or otherwise -- that there is great opportunity for collusion under cover of ordinary business.

Because of the anticompetitive conduct in the industry and the close associations among the operations of competitors across the globe, the regulatory agencies and Congress should take a much more careful look at all levels of joint activity to discourage collusive activity

Legislative Proposals

The Committee was kind enough to share with me draft legislation designed to strengthen the current antitrust laws. This legislation proposes to prohibit unilateral withholding of oil and gas products when done with the intent of manipulating price, and to strengthen antitrust enforcement with regard to oil and gas industry mergers. It changes the standard for evaluating the possible anticompetitive effects of mergers and acquisitions in this industry, where increased consolidation is a serious concern, to bar any merger or acquisition that may "appreciably diminish competition." In addition, the legislation authorizes a study of the effectiveness of oil and gas industry divestitures previously required by the FTC and DOJ and the establishment of a joint federal and state task force to investigate information sharing among oil and gas industry participants. Finally, the legislation proposes to abrogate the doctrine of sovereign immunity and the act of state doctrine under certain circumstances.

I applaud the initiative of the Chairman and the Committee for addressing these important and timely issues. Even where output restrictions can be addressed under current law, the proposed legislation would significantly simplify and expedite preventing and remedying output restrictions of the sort engaged in by ExxonMobil and BP to the detriment of American consumers. For this reason, this newly drafted legislation deserves serious review and consideration.

In addition to the proposed legislation, another idea that deserves serious consideration is an examination of Hart-Scott-Rodino requirements, and the enforcement of those requirements, to ensure that the various unitization agreements, unit operating agreements and ancillary agreements, and joint venture operating agreements in the oil and gas industry receive appropriate antitrust scrutiny.