

Stranded Gas Hearings (0407281315 Minutes)

Access to Capacity for Alaskan Communities

Charlie Cole, Board of Directors, Alaska Gasline Port Authority, July 28, 2004.

MR. CHARLIE COLE, Board of Directors, Alaska Gas Pipeline Authority, said he wanted to talk about the Gas Act's provisions at Fairbanks.

I have to say preliminarily that I have some hesitation about speaking critically, you might say, about an item of legislation that passed the legislature by a vote of 20 – 0 in the Senate and 38 – 0 in the House. Obviously, any bill that passes the Alaska Legislature with votes like that has strong support and is viewed by informed legislators as good legislation for this state. So, with that caveat and that reservation, I want to speak a little bit today about the effect of that bill as I see it on Fairbanks and other Interior communities and in a sense, communities down river.

One, Alaska is cold and Fairbanks is, on occasions, very cold. It is one of the restraints on growth that we have in Alaska and we'll always have in Alaska – is the cold weather. With that given, low cost economic energy is vital for the economic development of, certainly, Interior Alaska and, as we have seen, how vital and how beneficial that has been to the Anchorage area. But, Fairbanks has not had that benefit and Fairbanks continues to struggle economically as respects quality of life for the high cost of energy there.

So, if one looks to the future of Fairbanks, if Fairbanks is going to have any economic growth... it must have cheap economic energy to offset the costs of living there.

The second given is that these Alaska resources should be primarily for the benefit of Alaskans. Isn't that what Governor Murkowski said? He said one of the fundamental purposes of the use of these resources of Alaska should be to benefit Alaskans.

Senator Seekins would know at times in Fairbanks when it's 50 degrees below zero, we have people there who buy 50 gallons of fuel oil to heat their house, to keep it from freezing, because that's all they can afford, if you can believe that. One of the givens for the Fairbanks community is we really need gas. There's only one place we're going to get that gas and that's off this gasline, if it's ever built. Presumably, it's going to be built.

Also, if we want to keep the military bases in Fairbanks – you know those base closure proceedings come up every once in a while. One of the criticisms we talk about keeping Eielson and Fort Wainwright there is how much it costs to keep those bases open. If we're trying to reduce the defense budget, maybe we're trying to, I'm not really sure that we are, but if we are, we've got to reduce the cost of power and heating at those bases. So, that should, in my view, be given as a policy.

So, what did the Stranded Gas Act do for Fairbanks in that regard? Given I think those unanimous policies – lets just read what AS 42.06.240 says in that regard.... starting with section (f).

In addition to the other requirements of (a) through (e) of this section, the provisions of this section shall apply to a certificate of public convenience and necessity for a North Slope natural gas pipeline carrier or a person that will be a North Slope natural gas pipeline carrier under this chapter.

(1) The person making the application shall dedicate a portion of the pipeline's initial capacity sufficient to transport the total volume of North Slope natural gas that has been committed by the producers and shippers of North Slope natural gas to tendering for intrastate firm transportation service at the time that the operation of the North Slope natural gas pipeline commences.

(2) Upon receipt of the certificate application under this subsection, the [RCA] shall issue a public notice inviting prospective intrastate shippers of North Slope natural gas to file a request for service. A request for service submitted by a shipper in response to the notice issued under this paragraph must include a proof of the shippers commitment to use the North Slope natural gas pipeline for intrastate firm transportation service, specifying the volume of North Slope natural gas that the shipper will tender for initial intrastate firm transportation service.

(3) In its review of an application submitted under this subsection:

(A) For the purpose of evaluating the total volume of intrastate transportation of North Slope natural gas to be accepted for initial intrastate transportation, the [RCA] commission shall determine the total volume based upon written commitments to tender North Slope natural gas for intrastate firm transportation service continuously for a period of not less than three years after the operation of the North Slope natural gas pipeline commences as follows (the RCA has to determine the total volume based upon written commitments (before the certificates of public convenience and necessity are issued and before pipeline construction begins – day one):

(i) Each request for service by an intrastate shipper that is a public utility, as that term is defined by statute, for the purpose of furnishing natural gas for ultimate consumption within the state by its customers that individually consume an average annual volume of less than 20 million standard cubic feet of gas per day shall be supported by a written commitment by the public utility that sets out the utility's best current estimate of the average annual volume that the utility will require during the three-years period.

MR. COLE emphasized that a written commitment gives the sense of something that is binding and obligatory, but after reading the next sentence, it may not mean contract.

(ii) Each request for service by an intrastate shipper that is not a public utility, as that term is defined by law, and each request for service by a public utility for the purpose of furnishing natural gas for ultimate consumption within the state by a customer that individually consumes an average annual volume of 20 million or more standard cubic feet a day, that purchases North Slope natural gas from a North Slope natural gas producer must be supported by one or more contracts for the purchase of the North Slope natural gas on a take or pay basis that extends for a period of not less than three years after the operation of the North Slope natural gas pipeline commences.

MR. COLE explained that means that anybody who wants this natural gas, if it is not a public utility or it is a public utility with more than 20 million standard cubic feet per day, you have to reach a contract now to buy natural gas from the carrier on a take or pay basis. Fairbanks has no natural gas distribution system or facilities for converting natural gas to electrical energy; so, who in Fairbanks would enter into a contract like this, he asked. He didn't know how such a project would be financed and supposed that it would be impossible.

CO-CHAIR OGAN interrupted to say that LNG is being shipped from the Matanuska Valley to Fairbanks at \$7 per thousand CF and it wouldn't take too much to set up a turbine to turn the natural gas into electricity.

MR. COLE responded that it wouldn't be very practical to enter into a contract now without knowing what rates the RCA will set and approve as just and reasonable. Fairbanks needs a whole distribution system for homes to be heated and no one knows what that would cost and no one would finance it. However, he noted that was only part of the dilemma. The next section says:

(iii) The RCA may consider peak volume specified in written commitments of the North Slope natural gas producers and purchase contracts; and

(B) The commission shall set out in its order granting a certificate of public convenience and necessity the total volume of intrastate North Slope natural gas that the North Slope natural gas pipeline carrier shall accept for intrastate transportation.

MR. COLE said that means the certificates of public convenience and necessity shall say the total volume of intrastate gas may not exceed the volume substantiated by written commitments and contracts that comply with the requirements of the chapter. Commitments have to be in place, then the RCA in the

certificate of public convenience and necessity says, "You've got to send out X, but you can't ship any more for intrastate transportation."

He emphasized that it gets worse:

If the North Slope natural gas pipeline carrier wants to transport gas in excess of the amount set forth in the statement of total volume of the pipeline carrier's certificate of public convenience and necessity, the pipeline carrier may apply for authority to transport more.

MR. COLE explained that means the carrier has to see if it can get authority to do that.

We're looking at a gasline that's going to potentially be running by Fairbanks for the next 30 years. How are we ever going to, for example, entice anyone else to come to Fairbanks and utilize this natural gas for a petrochemical facility? What about supplying natural gas to Fort Wainwright? Converting those bases? And how are we going to furnish natural gas to Eilson Air Force Base? Once, ten years down the road, it then becomes up to the gasline to decide whether they want to increase the intrastate capacity for Fairbanks. And I'm not talking just about Fairbanks and Eilson and Fort Wainwright, I'm talking about Tok, I'm talking about Delta Junction on the way down the Highway, but I'm also talking about the development of propane facilities to be able to ship propane down river to these other communities. I mean, once you do this, [it] is locked in. Then it's up to the pipeline, itself, to decide whether it wants to increase the capacity – and that's over the next 10, 20 or 30 years or maybe 50 years.

This is legislation, which I think is ill-advised, if I may say. That's a little strong for people who voted 58 – 0; I realize that. But, I think for the reasons I've given you, this Legislature should take a look at it and decide whether it needs to be revised. Probably 90 percent of what you hear in these hearings you have no control over. It's under the control of FERC. This is something you can do something about – to encourage economic development, to improve the quality of life in the Interior, the Interior villages and down the highway and down river.

SENATOR BUNDE asked if he anticipated that the gas the state would sell in-state, because it's in the state's best interest to get the highest return, would be at the same price as the gas sold out of state, less the cost of transportation. He didn't see any incentive to not increase capacity for Fairbanks if the state would get the same net return.

MR. COLE responded:

Why would you allow that decision to be made by the pipeline, itself? I think one of the vices of this is for the next 30 or 40 or 50 years, as long as this gasline is there, it is the pipeline, itself which makes the decision. Does it want to apply to the RCA to increase the intrastate capacity? We shouldn't, in my view, allow that decision to be made by the carrier. The decision should be made by either the RCA or by others and not grant it exclusively to the pipeline. They can stifle the developments of Fairbanks and the Interior and the villages and down river for the next 50 years by simply saying if the North Slope natural gas pipeline carrier wants to transport more, it can file the application? Why do we give them that exclusive right?

SENATOR BUNDE responded that a phrase comes from Fairbanks legislators fairly often – "A stranded gas tax would encourage them to be friendly to Fairbanks."

MR. COLE responded that he would like to talk to the people from Fairbanks who voted on this.

SENATOR SEEKINS said he wasn't there during that conversation, but he wants to talk to Mr. Cole before the legislation passes. He also said that take or pay contracts are pretty standard in the natural gas industry and you generally need some of those on hand to show banks that you can borrow the money and repay it.

MR. COLE replied:

Senator, this is a small infinitesimal amount of capacity of that line [BREAK IN THE RECORDING].... It's not a major accommodation to the pipeline carrier when you consider the consequences to Fairbanks. I tell you, Fairbanks is going to dry up and blow away over the next 30 or 40 years if somehow we don't reduce the cost of energy there. This is a barrier to that –

plain and simple.

SENATOR SEEKINS noted for the record that all the new construction in his area is being heated by Fairbanks natural gas and their distribution system continues to expand there, even though they are bringing in LNG.

MR. COLE said his statement proves his point of the crying need for cheap gas in Fairbanks. He repeated:

It's a crying need and why do we want to initiate, by legislation, barriers to that development, our policy should be the opposite. We should enhance it and further.

Let me talk take or pay contracts. The problem with take or pay contracts is when you have the situation you have in Fairbanks. Sure, I can see Enstar taking a take or pay contract. It has the distribution system, it has the industrial development here to do it; I mean that's a no-brainer. But, we're talking about Fairbanks, which has none of that. We're starting from scratch. We shouldn't put that burden on the people of Fairbanks to have a take or pay contract when they don't know the price of it; they don't know how much it's going to cost to develop the distribution system in Fairbanks; they know nothing.... The problem is that it's going into the unknown. The problem is peculiar to Fairbanks.

REPRESENTATIVE HAWKER said he wasn't in the Legislature when this bill was adopted and said, if Mr. Cole's suggested remedy of repealing the Act would happen, there would be no statutory requirement for capacity dedicated to intrastate transportation.

MR. COLE replied:

Not to totally repeal it, of course – to repeal this particular section and revise it with something a little more balanced for the need we have in the Interior. There could be, with expert testimony, the amount of intrastate capacity that needs to be reserved and then, within a given period of time or in segments over a period of time, if it's not used within that period of time, then it reverts. You see, I'm looking for 30 and 40 and 50 years. We look, too often, I think, to today and tomorrow and the next three years, but I'm looking for three generations of Alaskans.

REPRESENTATIVE HAWKER asked if he had this conversation with any of the major players who are proposing pipelines to solicit their support.

MR. COLE replied emphatically, "No."

REPRESENTATIVE GARA said he was trying to understand the disincentive for the pipeline owner to let gas be delivered in Fairbanks.

Is it, if they are going to carry a full load of gas from the North Slope down to Fairbanks, they make more money by bringing it all the way down the pipeline than they do in just charging to drop it off at Fairbanks and that's the disincentive you're worried about?

MR. COLE replied that he hadn't spoken to prospective pipeline owners on what they are worried about. I would imagine they would want to make commitments down-line and they don't want to have to be monkeying around with this relatively minute capacity in Fairbanks. I can understand their incentives and their needs. I just think that we need to tinker with this a little bit to allow Fairbanks and the Interior communities to have the incentives.

I went down to Tok a couple of years ago and we had a hearing there. They said, 'What's in this for us? We want gas here, too.' This gives them essentially no opportunity to ever have gas. Not today or tomorrow, but to ever have gas. That's one of the problems that I see. It's sort of shortsighted and I think it's not unreasonable to ask the producers, the owners of this gas, to make these accommodations for the best interest of Alaskans.

SENATOR THOMAS WAGONER said Ninilchik has some new discoveries and it has the same scenario - a small community and the people want the gas, but the problem is do they want to pay for a station to depressurize that gas down to a lower pressure and pay for the infrastructure that it takes to distribute that gas. Do they want to do an LID (local improvement district) for 10 years?

MR. COLE responded that his sense is to give the people of this state the benefit of warm houses and a quality of life that other people in the Lower 48 enjoy.

We're right there on the line and we can't get it? Now, what are we missing? I mean, we're right there on the line – and we can't get it because we can't tell the owners of this gas you have to make some accommodations to these Alaskans whose natural gas you're piping out to the east coast. I don't get it!

CO-CHAIR OGAN said that the gas in Cook Inlet has a lot of liquids and those have to be stripped out to process the gas. "Hopefully we'll have a thriving petro-chemical industry in Fairbanks to get some of those liquids before Alberta gets it all."

CO-CHAIR OGAN thanked Mr. Cole for his testimony and directed that a letter from Representative Whitaker be typed into the record before testimony from Mr. Persily, Department of Revenue was taken. The letter follows:

July 27, 2004

Senator Scott Ogan
Chair, Senate Resources Committee
Alaska State Legislature

Senator:

Senator Ogan, the request from Bonnie Robson, the consultant to the Legislative Budget and Audit Committee for Alaska Natural Gas Pipeline Issues, is very clear. The subject matter for discussion is to be: "What is your company willing to offer on access beyond what is required by law?"

My testimony was going to be and still is as follows:

Current Alaska law provides for a broad policy directive:

- The Alaska constitution, Article 8, sections 1 and 2 that directs: "It is the policy of the state to encourage... the development of its resources by making them available for maximum use consistent with the public interest." And that, "The Legislature shall provide for the utilization, development and conservation of all natural resources belonging to the state, ... for the maximum benefit of its people."
- AS 38.35 The Right of Way Leasing Act – "The natural resources of this state,...and in its land for transportation of these resources...toward markets both in and out of the state are capable of making a significant contribution to the general welfare of the people of this state. It is the policy of this state that the development, use and control of a pipeline transportation system be directed to make the maximum contribution to the development of the human resources of this state, the increase in the standard of living for all of its residents, the advancement of existing and potential sectors of its economy, the strengthening of free competition in its private enterprise system and the careful protection of its incomparable natural environment."
- AS 43.82 Stranded Gas Development Act – "maximize the benefit to the people of the state of the development of the state's stranded gas resources"

Unfortunately, with the passage of HB 290 by the twenty-first Alaska Legislature in 2000, that broad policy directive is precluded in that the law puts an overwhelming burden on local utilities and communities to commit to purchase for firm transportation a definitive amount of natural gas without knowing what their future demands will be, without knowing what the tariff rate will be or the methodology for gas valuation will be or from whom they will purchase gas or even if it will be available.

Further, HB 290 exempts a North Slope natural gas pipeline from a requirement to serve as a

“common carrier” for anything other than instate use of gas. There is no realistic provision in law that requires the owners of a gas pipeline to provide access for out of state shipping capacity to any other would be competitor.

Simply put, despite a broad policy directive to the contrary, it is probably that under existing law, Alaska’s communities will have limited access to North Slope natural gas. Further, it is probably that would-be competitors will be precluded from shipping natural gas, thereby eliminating the potential for a competitive free enterprise market from which all Alaska benefits.

Fortunately, timely solutions do exist. When HB 290 passed, it was clear that a time of reckoning lay beyond; when the legislation would have to be reviewed and changed. We knew that because, while HB 290 was the best we could do at the time, ultimately it did not meet our constitutional obligation. That time is now. The first set of solutions will require that the law be changed to provide a more probable opportunity for community access and competitive access for would-be gas explorers and producers. A second solution is public ownership of a North Slope natural gas transportation system. The Alaska Gasline Port Authority, a municipal entity created in 2000 by an overwhelming majority of voters and the Alaska Natural Gas Development Authority, a state entity created by initiative in 2002, and approved by a significant majority of voters, are both committed to ensuring access to any would-be producer and also committed to providing access to supply for all Alaskan consumers; be they utilities, industrial or other user groups.

Ready markets exist for Alaskan natural gas. The supply/demand dynamic is such that the economics of a project are predictable and positive. Supply at a fair value must be made available to the project that most benefits Alaska and Alaskans. It is the Legislature’s constitutional responsibility to ensure that supply at fair value be made available. That responsibility and subsequent action may from time to time require a reasonable legal and commercial confrontation or negotiation between the Legislature and the major leaseholders of Alaska’s North Slope natural gas: British Petroleum, Exxon and Conoco-Phillips. A negotiation or confrontation of this nature between the state as the owner and the leaseholders is necessary and healthy. After all, much can be gained or lost on both sides. The Legislature’s responsibility is to fairly gain a maximum benefit for the people of Alaska.

N. Jim Whitaker, Mayor