Stranded Gas Hearings
(0501261325 Minutes)

Presentation from Alaska Gasline Port Authority –
Jim Whitaker, Chairman, Alaska Gasline Port Authority;
Darcel Hulse, President, Sempra LNG;
Rigdon Boykin, Attorney at Law for O'Melvany & Myers and Special Counsel for Alaska Gasline Port Authority, January 26, 2005.

JIM WHITAKER, Chairman, Alaska Gasline Port Authority (AGPA), presented the AGPA's "Port Authority Report and Pledge" for development:

> A listing of commitments that the port authority is making to the legislature, the governor, and the citizens of the state. The Alaska Gasline Port Authority will, number one, cause to be constructed, own and contract for operation of components of an All-Alaska Gas Pipeline Project, which will include: a gas conditioning plant on the North Slope to process 4 to 6 bcf [billion cubic feet] per day of gas. A 48-inch pipeline to carry 3 to 4.5 bcf per day of gas to Valdez. A spur line from Glennallen to Palmer to carry .2 to .05 bcf per day of gas. A fractionation plant in Valdez to process propane, butane, and other potential gas liquids. Liquefaction facilities and related storage and docking facilities. Pipeline construction is scheduled to begin in 2008, with a projected gas delivery date at the end of 2011 or the beginning of 2012. In order to meet this development schedule the port authority has signed an agreement with Sempra LNG under which Sempra would participate in project development and purchase between 2.5 and 4.5 bcf per day of gas to liquefy and market. We have obtained exclusive rights to project permits of the Yukon Pacific Corporation. We have entered into a protocol agreement with the State of Alaska. We have worked with the Alaska congressional delegation to add language to the federal omnibus appropriations bill, that clarifies applicability of a federal loan guarantee to an all-Alaskan gas pipeline.

MAYOR WHITAKER continued:

> Item two; we commit to negotiate for the purchase of ANS [Alaska North Slope] gas. While initial negotiations for the purchase of project gas supplies have begun with one or more major ANS gas producers, the Port Authority will follow an aggressive schedule to obtain adequate supply of natural gas to fill full project capacity. In addition to gas under current negotiations the Port Authority will negotiate with the state for the purchase of royalty gas and with other ANS lease holders who express an interest in selling gas to the project.
>
> The Alaska Gasline Port Authority commits to provide guaranteed gas supplies to Southcentral and other parts of Alaska. The Port Authority {indisc.] with its agreement with Sempra LNG [liquefied natural gas] has committed to provide adequate supplies to meet current and future natural gas demand within the state. The Port Authority also commits to cooperate with the Alaska Natural Gas Development Authority [ANGDA] and others, as appropriate, to develop the infrastructure necessary to deliver natural gas to Southcentral Alaska and other communities. Further, the Port Authority will provide multiple off-take points to provide for future natural gas land.
>
> Number four, the Port Authority commits to provide petro chemical industries in Alaska ... The Alaska Gasline Port Authority commits to make adequate natural gas liquids available to support existing and future petro chemical industries within the state. Number five, the Alaska Gasline Port Authority commits to market gas to West Coast consumers. Through its agreement with Sempra LNG the Port Authority will transport up to 4.5 bcf per day of natural gas from Prudhoe Bay to Valdez for liquefaction and transport to market.

MAYOR WHITAKER added:

> Number six, the Alaska Gasline Port Authority commits to provide for maximum market opportunities for ANS natural gas. In addition to its agreement with Sempra to market ANS gas to North American West Coast markets, the Port Authority will market ANS gas to in-state gas consumers and distributors. Also, the structure of the Port Authority allows for future expansion of

capacity and market diversity. That can include natural gas deliveries, by a pipeline through Canada to supply markets in the central U.S. and additional opportunities in other North American markets.

Number seven, the Alaska Gasline Port Authority commits to provide a direct revenue sharing benefit to the state and each municipality. The Port Authority commits to a revenue sharing program that provides an annual share of net Port Authority project revenues to the state and each municipality based on population. Based upon current economic and market assumptions the projected amount to be received in the first full year of operation by the state and the municipalities is estimated to be in the range of $370 million subject to final project costs, that is in addition to royalty and severance taxes.

MAYOR WHITAKER continued:

Number eight, the Alaska Gasline Port Authority commits to provide for payment of impact funds to communities affected by construction of the project. The Port Authority recognizes that significant impact to the state and communities during the preconstruction through post construction phases of the project will occur. As recommended by the Municipal Advisory Group the Port Authority will provide for payment of fairly established impact funds directly to the state and to the communities economically impacted by the project. Number nine, the Alaska Gasline Port Authority commits to provide for Alaskan hire to the greatest extent allowable by law. The Port Authority [indisc] will include contracting with qualified Alaska businesses, requiring project contractors to advertise within Alaska for positions and taking steps to monitor their success of project participants in achieving this goal. Further the Port Authority supports the training of Alaskans for pipeline construction and operation positions to the greatest extent possible. Additionally, the Port Authority anticipates negotiating [a] project labor agreement with local labor organizations.

MAYOR WHITAKER concluded:

Number ten, the Alaska Gasline Port Authority commits to provide for maximum access to pipeline capacity for North Slope natural gas commercialization. The Port Authority will fairly negotiate with all interested current and future ANS gas producers for the purchase of Alaskan natural gas supplies to fill project capacity. This commitment was passed by the Board of Directors of the Alaska Gasline Port Authority on the 25th of January and has been signed.

MAYOR WHITAKER stated that Sempra LNG and the Port Authority are proposing an All-Alaska Gas project; a gas pipeline from Prudhoe Bay to Valdez, and an integral part of the project is a spur line to Southcentral Alaska. The all-Alaskan alternative can move stranded gas to market more quickly than any other alternative, he noted. He related his belief that [the all-Alaskan alternative] will provide a very competitive price for gas and a better process for liquefied propane gas (LPG). The infrastructure regarding an all-Alaska project is in Alaska which translates to: a better economy, more employment opportunities, more gas use for the state of Alaska. Moreover it preserves the ability to serve both the West Coast and the Midwest markets, and positions Alaska to expand into the market place, he noted.

MAYOR WHITAKER related that the Port Authority was formed by the city of Valdez, the Fairbanks North Star Borough, and the North Slope Borough. Through ballot propositions [that received support] in the range of 80 percent. The Port Authority was established to develop an all-Alaska alternative. "The Port Authority's mission is consistent with Alaska law, from the Statehood Compact to the Statehood Act, to the State's Constitution, to the Right of Way Leasing Act, and to the Stranded Gas Development Act," he stated. The Port Authority is consistent with the law, in that it will provide a maximum benefit to Alaskans by developing Alaska's North Slope gas, he noted. The Port Authority will provide for the maximum use of Alaska's natural gas throughout Alaska and also attract new industry. The Port Authority would deliver natural gas to the North American markets at long-term competitive prices. He mentioned that there would be a significant improvement to the value of the state's natural resources by providing a tax-exempt structure.

MR. HULSE explained that Sempra Energy is the largest U.S. utility from a customer base. The company serves approximately 23 million people through their gas distribution systems.

MR. HULSE stated that Sempra has the market capabilities to sell gas. They focus on four major areas; commodities which is their trading business, generational business, pipeline, and storage business, and the LNG [liquefied natural gas] business. Sempra was rated by Platts Gas Daily, whom publishes market capabilities and ranks companies in the market place for their ability to sell gas, Sempra moves about 13.5 bcf per day in North America. Sempra is not a producer company, instead they are a downstream marketing and infrastructure company, and Sempra is the second largest marketer of gas next to the producer company of BP.

DARCEL HULSE, President, Sempra LNG, stated the letter of decision for the All-Alaskan Project relayed that as a government entity the AGPA is exempt from federal taxation, which could bring significant benefits and economics to the project. He noted that AGPA was able to include this project in federal loan guarantees. Sempra has signed an agreement with the AGPA to assist in the development of this project and will be able to manage the marketing of gas. Marketing the gas is where Sempra brings strength to this project, he noted.

MR. HULSE described the details of the project. A gas conditioning plant will be constructed on the North Slope in order to separate primarily CO2 and ethanes. The CO2 and ethane's will turn from .9 bcf a day to 1.4 bcf per day of those products, which will be used as miscible injections for enhanced oil recovery. Then the gas conditioning plant will send the remainder which will be methanes, propanes, and butanes down the all-Alaskan pipeline where at Glennallen it will be able to serve and separate natural gas for support of industry and for heating purposes. The remainder will flow to a LPG fractionation plant that will separate the propanes and butanes; the estimates are between 150,000 to 225,000 barrels a day, which is a very significant size in that market place. The product can be marketed either in the Gulf Coast of the U.S. - where it could obtain a higher price - or in the Asian markets, he noted. The natural gas will be marketed separately. The LNG will then be moved to the West Coast, and that produces 2 to 3 bcf a day of natural gas in liquid form.

MR. HULSE stated that the current scheduled timeframe for completing the permitting process, finishing all the right-of-ways, the loan guarantee, and the construction is about four years. The timeframe would allow the project to be able to move gas to the market place at the end of 2011 or 2012.

MR. HULSE informed the committee that there is about 6,000 trillion cubic feet (tcf) of proven gas reserves in the world today and on a daily basis the world consumes about 90 tcf of gas. Therefore, there is about 65 to 67 years of proven gas supplies in the world today. Mr. Hulse pointed out that gas only brings value to its owners when it is able to find a market place. He indicated that the West Coast market is one to capture, as is the Mid-West at a later date.

MR. HULSE stated that according to the Alaska Division of Oil and Gas, there is approximately 35 tcf of crude reserves in Prudhoe Bay. As an aside, he noted that the estimate of other conventional gas that has not been discovered may be another 242 tcf. He suggested one option to solve the shortage is gas hydrates. If the technology for hydrates is fully developed, then Alaska is sitting on one of the largest gas resources in world. The gas could be moved to market, and there would be enough gas to supply all of the U.S. at the current rate of consumption for 1,200 years.

MR. HULSE highlighted that Alaska needs to be able to move and monetize large volumes of gas. He reiterated the need to capture the West Coast market because if it isn't captured, it could be lost to foreign sources. Under long-term foreign sources contracts the West Coast market would be an unavailable market for a long period of time. If the West Coast market is captured now it preserves the opportunity for Alaska to have both markets: the West Coast and Mid-West.

MR. HULSE stated that there are numerous benefits to the All-Alaskan Gasline Project. For instance, it will be a significantly greater capital investment in Alaska. Alaska will have more control over the timing of the project, greater economic benefits, in addition to new business, industry, and jobs. Furthermore, the tax-exempt structure yields greater revenues for the state and the producers. Overall it will yield greater benefits to Alaska, he opined.

MR. HULSE compared the Mid-West market to the West Coast market, which is the bigger market. On an every day average the West Coast is about an 8 bcf per day market while the Mid-West is a 6 bcf per day market. In recent past, the Mid-West has been a $0.10 better market than the West Coast. However, the West Coast stands to be a better premium market long term, he noted.

MR. HULSE stated that another important component is that the LPG sales would generate about one-third of the income of the project. If those liquids are placed in the Alberta market or in the Mid-West, it would flood the market place. As a result, there will be a depression in the price in that area. Simultaneously, there would be a depression in overall netbacks and the value to the state and the producers. Bringing the LPG's to Valdez correlates with direct access to Asian and U.S. Gulf Coast markets. Mr. Hulse stated that by bringing the LPG's to Valdez there would be a 30 percent greater price advantage than by going through Alberta.

MR. HULSE informed the committee that Alberta produces about 300,000 barrels per day of which amounts to about 260,000 barrels per day are consumed and 40,000 barrels per day are exported to the Lower 48. The Lower 48 has to import another 160,000 barrels per day of liquids. Mr. Hulse proposed that by combining the Canadian Highway Project and the Mackenzie Delta Project the numbers total about 265,000 barrels per day into that market place. Canada will need to export about 305,000 barrels per day and the Lower 48 will have to export more. Therefore [Alaska] will need to build pipelines in order to get rid of that excess quantity of liquids, he noted. However if the all-Alaskan pipeline exported to the West Coast and the Mackenzie Delta project were constructed, the market wouldn't be flooded, and prices would remain where they are currently.

MR. HULSE relayed that the Asian market imports about 710,000 barrels per day. He highlighted that LPG sales in Japan are generally some of the highest of any major market, while in comparison LPG prices in Edmonton are generally some of the lowest in North America. The LPG prices in Japan market averaged $0.14 per gallon or $5.90 per barrel premium to the Edmonton market. The premium could get higher if the Edmonton market was flooded. Mr. Hulse estimated that the premium could be as high as $0.20 and it will probably take $0.09 of the pipeline capacity to move it to another market. That being the case, Mr. Hulse specified that it could be at least the $0.14 plus whatever the pipeline charge will be to move it to another market. He proposed that the LPG price differential of $0.20 per gallon impacts the producer netback of $0.40 a million BTU [British thermal unit] less value on gas. Mr. Hulse stated that this factor has one of the most significant impacts of the project and bringing the products out at Valdez makes more sense in terms of economics and value for the state. The cost to move the LPG from Valdez to Japan is likely to cost $0.02 to $0.03 per gallon. Getting LPG price out of Canada and the Mid-West and into the world market place will produce a 30 percent premium.

MR. HULSE summarized his presentation by reviewing the economics of the project. Sempra is aware of the LNG costs worldwide and although it is certain that Alaska will be similar in cost, there are numerous benefits from this project. The Alaska Gasline Port Authority structure and the West Coast marketing bring the upside of the benefits to this project by adding net present value to the project, plus the liquid price is about $450 million per year of added value. It will be imperative to capture the West Coast market for moving large amounts of gas out of Alaska. In addition there will be future possibilities to expand production through a line to Canada and down, he noted.

RIGDON BOYKIN, Special Counsel, Alaska Gasline Port Authority, mentioned that there does not currently exist in the U.S. the capacity to build large LNG tankers required for a project of this magnitude. Mr. Boykin noted that Sempra and AGPA are

not asking for any reductions of taxes or any other "give-ups" from the state. REPRESENTATIVE SAMUELS asked if Sempra will be increasing the amount of Alaska gas or replacing it with another current supplier.

MR. HULSE stated that Sempra is always looking to increase its business: Sempra would not be able to move 13 bcf/day "unless we've had a lot of long-term customers." Sempra would seek "whatever longer term contracts" it could obtain. However, Sempra is comfortable with moving that volume of gas in the market place, he noted.

REPRESENTATIVE SAMUELS noted that the All-Alaskan Gas Project called for an increase in the re-gas plant in the Baja from 1 to 3 bcf. Representative Samuels then asked, "If you are going to take 2.5 to 4.5 bcf, what are you going to do with the rest of the gases?" He noted, that in terms of a market that is a wide range.

MR. HULSE replied that when it comes down to actual gas moved after extracting the liquids and supplying gas to the state, the number will be down to 2 to 3 bcf daily. He said although there are other West Coast facilities through which Sempra believes it could move the gas, it is a matter of marketing the gas. The facilities for the project will be built to move the gas. Gas from the U.S. is particularly movable as opposed to gas from foreign sources. He stated that Sempra is confident in its capabilities to move the gas.

CHAIR THERRIAULT asked about the potential West Coast market.

MR. HULSE responded that the states of Washington, Oregon, California, Arizona, and Nevada and Baja consume about 9.5 bcf of gas per day. However, these states only produce about 700 to 800 million cubic feet a day, and Sempra imports about 90 percent of its gas to that market on a daily basis. Chicago's needs are currently all supply, he noted. Mr. Hulse stated, "if a gas pipeline comes down, there will be displacement and there will be more rational movement of the gas into the market place. The same thing will take place on West Coast." Sempra and the Alaska Gasline Port Authority believe that by 2012, Alaska could put 3.5 to 4 billion cubic feet per day into that market. Although it would take period of time to achieve displacement, it will be displaced, he stated. In California the gas market is facing [the fact that] all of the basins, aside from the Rockies, have peaked production and are in decline. Thus, it will be necessary to make up reserves. If the gas does not come from Alaska, it will come from foreign sources. He indicated that there are plenty of world reserves to fill that void. Mr. Hulse said that "Gas in the ground brings no value, as a matter of fact it has negative value because of the money that you spent to explore for it. And so until you can monetize it that value is negative. The only way you get value is to get it into a market and the market is what determines the value."

CHAIR THERRIAULT asked if Sempra had done an independent assessment of the validity of the tax-exempt status of the Port Authority.

MR. HULSE answered "yes," and added that Sempra has the information and the due diligence in regard to the tax-exempt status of the Port Authority.

CHAIR THERRIAULT asked about the purchase of the Yukon Pacific permits.

MR. BOYKIN related that Sempra has negotiated an option to purchase the permits and that option has been signed. The option allows Sempra and the Alaska Gasline Port Authority to: use permits during the development phase, to use the data it has, to obtain amendments to the permits, and to obtain the other permits needed to develop the project. If the project actually goes to a financial close there will be a further purchase price and possession of the entire company. During the option period, Sempra has the right to use the permits and the data.

CHAIR THERRIAULT asked if the Port Authority built in impact fund was on the order of $120 million in the proposal to the municipalities.

MAYOR WHITAKER stated that was the correct order of magnitude.

SENATOR BEN STEVENS asked if the Alaska Gasline Port Authority had signed the reimbursable agreement from the administration to date.

MAYOR WHITAKER specified that the Stranded Gas Act does not apply to the Port Authority. The Port Authority is not asking for anything from the state, he said.

SENATOR BEN STEVENS noted that the Alaska Gasline Port Authority was working under the existing fiscal regime for the tariffs. He also inquired if the proposal was contingent on the contract shippers and if that would bring the project to sanction.

MAYOR WHITAKER stated, "It is required...that there be a supply given that there is a market and that there is a means to market." That being said, the supply agreement is currently under discussion, he noted.

SENATOR BEN STEVENS inquired about the methodology to sanction. He added if the methodology was first to market the gas and then supply the gas or vice versa.

MR. HULSE stated that both the methodologies have to come together simultaneously.

CHAIR THERRIAULT inquired about whether the Alaska Gasline Port Authority and Sempra may or may not be talking to one or more of the producers. He asked if Sempra would be proposing a fixed fee for the gas or a price associated with some hub price.

MR. HULSE relayed that Sempra signed the first gas contract with Indonesia on the LNG business and that is based on a border index. Mr. Hulse opined that long-term supplies from Alaska could possibly attract fixed price contracting. Although might be interested parties in fixed price contracting for the All-Alaska Gas Project, Sempra is not in a position to guarantee that. However, there may be interest from the market place because of fixed priced contracting and Sempra would like to explore that option, he noted.

SENATOR WILKEN expressed interest in Sempra's commitment to the project, and requested a brief review of Sempra's past, current, and future commitments contemplated for this project.

MR. HULSE stated that Sempra has made a commitment to develop the project and has backed that commitment with money. Sempra is committed to developing the gas with only one stipulation, the route it desires. Sempra feels this [all-Alaska project] is an ideal solution for future generations of Alaskans as well as future generations of those who live on the West Coast of the United States.

SENATOR WILKEN commented:

> In Mayor Whitaker's statement I think I heard him say that you signed an agreement to purchase 3.5 to 4.5 bcf of gas, so in simple terms does that say to me that if we can find a seller you have entered into a formal agreement to buy at least 3.0 bcf of gas.

MR. HULSE stated that the terms and conditions of the details still have to be worked out. He explained that Sempra has made a commitment to move that volume of gas. Sempra would mold the Alaska Gasline Port Authority's tax structure to purchase and move gas to maximize that benefit. He said that Sempra is confident that whatever the tax structure, it will have the capabilities to move the gas to the West Coast market place.

CHAIR THERRIAULT inquired about the Jones Act and asked if Sempra was basing its request for tax exemption from the "construction portion" because it was "moving United States resources to serve the United States' market."

MR. HULSE agreed, and said it does not make sense for Alaska's gas to go to Japan just because "they can get more money for it" based on the regulations of the Jones Act.

CHAIR THERRIAULT noted that part of the project was to move liquid gas over overseas.

MR. HULSE replied that "we fill all of the U.S. demand for liquids, and you move what's left." He also noted that the Port Authority pointed out that "one of the opportunities with that volume of liquid is to build, in Alaska, the businesses, the petrochemical businesses...that could use that as a feed stock, and sell finished products, of which would furnish you with more jobs..."

CHAIR THERRIAULT asked about the lost revenue to the state if the pipe was not taxable, and he asked if that money would be made up by sharing a portion of the added value from the gas liquids.

MAYOR WHITAKER said "kind of," and added that 60 percent of the net operating revenues will accrue to the state, 40 percent will accrue to municipalities, and he referred to Mr. Boykin to describe additional monies.

MR. BOYKIN stated that, in the budget, Sempra included a payment to communities in lieu of taxes.

MAYOR WHITAKER said it also includes payments to the state.

REPRESENTATIVE HAWKER asked for further clarification on the project's presumed non-taxable status. He said the witnesses referenced a private letter ruling obtained from the Internal Revenue Service, and he asked if the ruling addressed the existence of the Port Authority or does it specifically address "this proposal, these activities" by the Port Authority.

MR. BOYKIN responded that the ruling from the Internal Revenue Service was "in some respects generic and in other respects was quite specific as to what would be done here with a Port Authority structure."

SENATOR BEN STEVENS asked if there is a sponsor willing to propose the Jones Act exemption at the federal level.

MR. BOYKIN relayed that some maritime union representatives are working with Sempra on the issue.

SENATOR STEVENS clarified that he did not mean a union, but a United States operator of the ships.

MR. BOYKIN said it would be premature to talk to an operator until the producers are lined up, adding that he does not "want to fix a structure in place that they believe might adversely affect the netback for them."

REPRESENTATIVE DYSON asked why Sempra would want to buy expensive Alaska gas when it can be obtained far cheaper elsewhere.

MR. BOYKIN admitted that there are lower production costs elsewhere but noted the West Coast shipping costs. He opined that there is a compelling argument when comparing the economics between the U.S. and foreign markets, and that "in a declining resource, how we would let the Alaska gas not be brought down to the Lower-48 in one form or the other, and hence the loan guarantee." He said tariffs in the pipeline are similar to shipping costs, and world prices are supporting these projects "very well-- there is a very large netback." He related his belief that prices will not decline until there is surplus of infrastructure. He said that the rate of declining domestic production is "alarming," and it is the "perfect" time to bring Alaska gas to the market -- the economics are competitive. He added that going from one U.S. port to another U.S. port reduces the homeland security risks.

CHAIR THERRIAULT suggested that producers need long-term tax stability. MAYOR WHITAKER said he thinks that is a fair assumption.

CHAIR THERRIAULT asked what is the estimated total price of the gas operation from "start to finish."

MR. BOYKIN stated that Sempra has not looked at that, because it would buy the gas at the [wellhead] and sell it at the outlet of the LNG facility. It is difficult to come up with tariff because of the unknown destiny of the liquids in the gas. He said it is "cleaner not to operate on tariff basis but just flat out pay them for the gas at the wellhead." He said he is under the impression that the Stranded Gas Act is designed to generate additional revenues for producers as an incentive. He said that the possible price generated from an LNG facility is sufficient to not disturb the existing tax regime. He added that research has shown that netbacks would be "quite significant."

MAYOR WHITAKER suggested that is a discussion appropriate between the producers and the state, "we can make our economics very clear and very plain, and we are not requesting a reduction in the existing tax regime or royalty regime."

REPRESENTATIVE SAMUELS asked what would happen if Sempra went out of business and the contracts do not carry over to a new holder.

MAYOR WHITAKER said that there have been discussions with other entities. However, he opined that Sempra's financial strengths "are substantial."

MR. HULSE said those security concerns are addressed in contractual negotiations.

CHAIR THERRIAULT asked if the gas conditioning plant is owned and operated by the Port Authority or by Sempra.

MR. BOYKIN responded that under the Port Authority concept "the more of the infrastructure ... that we own, we feel the higher the benefit to the State of Alaska. Under our numbers and models ... we would envision owning the conditioning plant on the North Slope. That does not mean necessarily we would operate it." A producer might operate the facility under contract.

CHAIR THERRIAULT requested an update on talks with the administration.

MAYOR WHITAKER said that the cooperation with the administration is significant. He added that it is important to note, "we signed our agreement with Sempra approximately 60 days ago."

REPRESENTATIVE HAWKER opined that Port Authorities are autonomous and powerful, and asked how the state is protected from future changes in the share of returns going to the state.

MAYOR WHITAKER responded that there will be a contractual obligation, and the state can change laws if it is dissatisfied with its relationship with the Port Authority. He presented one caveat: once a bonding commitment is entered into, the state may not negatively affect that bonding relationship.

REPRESENTATIVE HAWKER said there is still some risk because the Port Authority may choose to take a direction that differs from current understandings.

MAYOR WHITAKER disagreed.