

Stranded Gas Hearings

(0407290830 Minutes)

Access to Capacity for In-State Manufacturing

William "Bill" Boycott, Kenai Nitrogen Operations General Manager, Agrium, July 29, 2004.

BILL BOYCOTT, General Manager, Kenai Nitrogen Operations, Agrium Inc., said he hoped to provide the committees with the perspective of a value-added manufacturer and relay some of its experiences and challenges in the Cook Inlet and how such may impact the legislature's decisions regarding North Slope gas. He remarked that differing paths in the production of North Slope gas could lead to very different outcomes as well as the development of other opportunities within the state. He went on to say:

The Cook Inlet natural gas actually generates about 15 percent of the exports from Alaska. That takes the form of ... about 200 [billion cubic feet (bcf)] a year of gas; about 80 bcf of that goes into the [liquefied natural gas (LNG)] facility for direct export. We, at capacity, consume approximately 53 bcf of gas, which we convert to anhydrous ammonia and urea - white pellets of fertilizer. And that export is going: ... the anhydrous ammonia primarily to Korea, the fertilizer all across the Pacific Rim but primarily Mexico.

MR. BOYCOTT relayed that he is quoting the following from a statement made by the McDowell Group that was used in a handout provided to the committee by Agrium Inc.: "By Alaska economic standards, the Agrium Inc. operation is exceptional for its combination of high pay levels, amount and concentration of expenditures in the local area, and the degree of value added manufacturing that occurs in Alaska prior to export. The result is a high multiplier impact." He noted value-added manufacturing consists of taking a resource and converting it to a product of higher value, and that value-added manufacturing occurs at the Agrium Inc. facility and at the refineries in Fairbanks, Valdez, and Nikiski area.

MR. BOYCOTT relayed that for Agrium Inc., value-added manufacturing results in a \$9.35 impact on the state's economy for every 1,000 standard cubic feet of gas that is consumed; this impact comes from Agrium Inc.'s payrolls, from businesses that provide support services to Agrium Inc., and from purchases of the resource. By extrapolating such information to the development of North Slope gas, he opined, one can envision that the potential impact on Alaska is quite large. He mentioned that with regard to international competition, there has been a lot of activity lately on the Australian shelf, Trinidad, and Venezuela; the foregoing industries are already developed to bring a product - such as LNG, methanol, and other petrochemical products - to market, beyond the ammonia and urea that Agrium Inc. is currently producing.

MR. BOYCOTT remarked that such industries share a common thread in that it takes a lot of technology and resources to convert natural gas into the aforementioned products, and so in areas where such conversion occurs, there has been a large impact on the local economy. He added: "This is an opportunity for Alaska. Value-added industry brings a lot to the state; if done properly, it has a potential to have a large economic impact on the state. Already, [from] what we see in the state, there is a large economic impact here, and there is potential for ... additional economic impact"

MR. BOYCOTT posited that a lot of industries worldwide are interested in developing gas resources, adding that the high economic multiplier of doing so also helps diversify the economy. He remarked that a large part of the Kenai Peninsula's economic base results from the presence of a refinery - the second largest in the U.S. with regard to nitrogen complexes - which has created a lot of diversity in that economic base. Developing a value-added manufacturing environment requires large amounts of gas that are readily available; entities looking to bring that gas to market in a value-added way; a conducive regulatory environment that will encourage development of the resource in a responsible manner; competitive pricing; an efficient infrastructure, whether new or existing; market access to the product; and political stability.

MR. BOYCOTT concluded by saying that some of the questions to be considered regarding bringing North Slope gas to market are whether Alaska would want to utilize some of the gas instate or just send all of the gas down to the Lower 48, and how best to position itself to take advantage of the gas.

SENATOR DYSON surmised that access to infrastructure means being at tidewater or at a deepwater port.

MR. BOYCOTT replied, "One of the things that we bring to the table in Alaska is that we have good access to the Pacific Rim; [at] the Cook Inlet [facility], we have deepwater wharf facilities." Because of this, agricultural products consumers in Mexico say that the quality of "the Kenai product" is the best they have access to and that they like its availability with regard to a short transportation time. Cook Inlet provides good access to the market, but there are still problems getting the product from the well to the consumer, he remarked, and such should be considered when looking at bringing North Slope gas to market; "We need to ensure that we encourage production of the resource, that the independents that want to come and participate are encouraged to do so and have ready access to the market with the product that they bring to the surface."

SENATOR DYSON raised the issue of competitive value and asked Mr. Boycott to comment.

MR. BOYCOTT said he has not seen numbers that will tell him "what will North Slope gas be delivered into." He mentioned, however, that the higher the gas price is, the more difficult it will be for anybody in a value-added industry to compete on an international basis. It is difficult to "make a call forward" because his industry is very cyclical, he added, and supply-demand levels can drive the value of the product up or down depending on many factors.

SENATOR DYSON asked, "Is it a good assumption that the world demand for nitrogen-based fertilizers will continue to increase?"

MR. BOYCOTT replied, "I believe that's true."

CHAIR OGAN asked about current prices.

MR. BOYCOTT replied that Middle East, Trinidad, and Venezuela's gas runs \$1.00-\$1.50; there is "some upward pressure" in the former Soviet Union, which used to send its gas into its plants for free.

CHAIR OGAN surmised that it must be pretty hard to compete with entities that get gas at those prices.

MR. BOYCOTT concurred, but mentioned that Agrium Inc. does have an advantage with regard to transportation into different markets; additionally, the overall world-demand plays a factor in product pricing. Mentioning the possibility of bringing a spur pipeline down into the Cook Inlet, he noted that such would provide access into the existing infrastructure. Currently there are constraints within that infrastructure; there are times when Agrium Inc. leaves gas at the well because it cannot transport it to its plant due to the constraints placed on that piping system. In looking to the future, he offered, it's important to consider not only how the new infrastructure is regulated, but also how the old infrastructure is regulated in order to ensure that gas will be brought into a system that is being managed in such a way that the gas can be effectively brought to market.

MR. BOYCOTT opined that sufficient infrastructure does exist to support all of the demand in the Cook Inlet, but reiterated that Agrium Inc. is not currently able to get all of the gas to market. Despite the fact that Cook Inlet gas is in decline, Agrium Inc. still finds itself in a position of not being able to transport gas due to private ownership and the current way the system is operated; "we have systems running below capacity and yet gas [is] left wanting to be moved." Agrium Inc. faces "private ownership of lines"; constraints on the infrastructure that are both physical and nonphysical constraints; affiliated ownership issues; restricted access; high transportation rates; "and, [in] our belief, [the fact that] the public interest is not always served, because we feel that the way the system is being utilized currently doesn't necessarily encourage the independent to come in and develop the resource."

MR. BOYCOTT continued: "As we look at other players who want to come into the Cook Inlet and

develop the resource, they find themselves in a position where ... they're constrained on who they [are] actually able to sell that product to because of ... access to the pipelines." He suggested that when considering North Slope development, the legislature should learn from what has gone on in the Cook Inlet in order to ensure that there will be open access to the pipeline systems at fair and reasonable rates. He cautioned that in developing the North Slope, the legislature should do what it can to ensure that the public interest is protected, that new entrants into the state are encouraged, and that business development is encouraged.

MR. BOYCOTT went on to detail some of Agrium Inc.'s motivating factors and its development in the Cook Inlet, and again commented on the potential for developing value-added industries in Alaska.

SENATOR WAGONER asked whether Agrium Inc.'s parent company does anything with gas liquids in Canada.

MR. BOYCOTT said not that he is aware of.

CHAIR OGAN asked Mr. Boycott to comment on what he sees in Agrium Inc.'s future with regard to gas supplies in Alaska.

MR. BOYCOTT indicated that Agrium Inc. anticipates being able to continue to operate [its Cook Inlet] facility through 2007, but acknowledged that continuing to find a long-term supply of gas might be problematic. He remarked: "I believe that ... if we open the market and open the infrastructure, that we will see the independents expressing an interest in working to develop the resource at competitive pricing."

CHAIR OGAN asked what Agrium Inc. contributes to the local borough tax base.

MR. BOYCOTT said he thinks last year's total tax burden was approximately \$2.5 million.