Stranded Gas Hearings

(0407291000 Minutes)

Access to Pipeline Not Subject to FERC Regulation

Harold Heinze, Chief Executive Officer, Alaska Natural Gas Development Authority (ANGDA), July 29, 2004.

HAROLD HEINZE, Chief Executive Officer, Alaska Natural Gas Development Authority (ANGDA), informed the committee that his presentation would be from the perspective of a public corporation of the state. He noted that he provided the committees with a copy of Title 38, the portion dealing with the state's position with regard to pipeline right-of-ways. He acknowledged that [the state] is preparing to consider Stranded Gas Act applications, which is different law. However, in Title 38, there is a very clear statement by the legislature with regard to the policy on how pipelines are to provide service and why. The policy, he emphasized, speaks to any pipeline, intrastate or interstate. Therefore, Mr. Heinze said he would translate the aforementioned policy into specific things that should be contemplated in this specific case of a pipeline going down the highway into Canada.

MR. HEINZE began by explaining that a takeoff point is [a point at which] gas can be taken out and something is done with the gas, and perhaps some of the gas or liquid is returned into the line. The take-off point could also be a place at which there could be production in the line. He highlighted that getting gas to the tidewater is a specific issue that's very important to Alaska. He said that he would specifically like to discuss the gas spur line to the Cook Inlet area. He turned attention to the Power Point presentation from the ANGDA, which included a diagram entitled, "Benefits to Alaskans". The diagram, he explained, illustrates things which could happen that could be good for Alaska [if there is a natural gas pipeline].

MR. HEINZE said that the obvious reason one would take gas off a large pipeline is to make electricity. The diagram lists some communities that he believes might have enough electrical demand that it would be worth putting in a major gas-fired, efficient, co-generation power plant. If gas is taken off the pipeline and propane is removed, [there could be propane distribution centers] as listed in his presentation materials. For instance, a propane distribution center in the Tok Northway area would be very significant in terms of impacting the residents' quality of life. All of the fuel in that area has to be brought a very long distance, and therefore the transportation component of the fuel cost for the area is very high. However, the fuel [from the natural gas pipeline] would be going right by the area.

MR. HEINZE remarked that it's logical to review some places for which the use of fuel is at a high enough density that there could be a distribution system for gas. Certainly, Fairbanks has enough of a population that it would make sense, at some point, to have a distribution system if there was a plentiful and affordable supply of gas. Additionally, the military bases represent areas for which there is a high concentration of energy use. Although all of the areas listed for the [electric power plants, propane distribution centers, and piped gas distribution systems] may not make the cut, there could be more than just two or three takeoff points. He opined that there should be take-off points for electricity, propane, and local distribution spaced at distances of at least every 100 miles and at least at every compressor station.

SENATOR DYSON inquired as to the number of customers it would take to make it economical for all of the [necessary equipment].

MR. HEINZE replied, "We really don't know yet." However, he said that one of the things that should be required as part of the Stranded Gas Act submittals to the state is a standardized, simple design to accomplish "these purposes." The testimony from TransCanada, he surmised, indicates the need for at least the concept of "stubbing out" in order to make connections. He said that such is fairly modest in cost. He emphasized that these are cost elements which he estimates are .1 percent of the $20 billion project. In this type of concept, he said he didn't envision the pipelines providing anything other than the "stub out." He opined that an unattended facility might work for 100 miles of highway line feeding propane and would work for a Glennallen-sized power plant. The issues of dropping pressure and cooling gas and

dropping out propane can be addressed via a very simple mechanical systems, he pointed out.

MR. HEINZE turned to the issue of getting gas to tidewater. The first important reason for getting gas to tidewater is because a large percentage of the population lives on the water. Therefore, getting gas to tidewater can result in getting gas to those communities on the water via barges or other methods. Between Ketchikan and Kotzebue there are at least 50 major communities that may be helped by having this type of energy availability and pricing. He noted that he is taking a long-term view. He then turned to LNG, which provides an economy of scale to "the loading" in Alaska. "The fact that you go into other markets with our gas allows you to achieve some economies of scale," he said, adding, "we keep the savings for ourselves ... - we lower our cost ... [in order] to get our fuel ... cheaper." Additionally, the notion of exporting may also help with the cost of getting shipments to coastal communities.

MR. HEINZE directed attention to the new industrial or manufacturing plants about which Agrium Inc. provided a presentation. He mentioned that Agrium Inc. painted the value-added feature in a way that is relevant to Agrium Inc.. However, Mr. Heinze pointed out that Agrium Inc.'s LNG plant and the fertilizer facility are large, but Agrium Inc.'s economics would improve with expansion. The reason Agrium Inc. hasn't expanded is a lack of supply. Therefore, if the state had a large amount of gas available for [Agrium Inc.'s LNG plant and fertilizer facility], Agrium Inc. would review the issue of expansion, and a certain number of entrepreneurial folks would be attracted. He clarified that he is referring to true entrepreneurs.

MR. HEINZE opined that gas to tidewater could be done at a cost of service, which would be a $1.50 under the delivery cost to the world market. The aforementioned $1.50 looks very possible in terms of a price advantage in Alaska. He noted that the ANGDA has been reviewing the spur line issue by choosing the Glennallen to Palmer project to review in more detail. The aforementioned project was chosen because, of all the possibilities, it's the only one without any right-of-way information on file with the state. Furthermore, the Glennallen to Palmer project seems to be a good model for any of the other spur lines in the system.

MR. HEINZE said that in about a month, the ANGDA will put out a report that includes alignment, potential costs of delivery of gas through the system, et cetera. Looking at this from an intrastate pipeline view, it would fall under the gas transportation pipeline part of the statute, AS 42.06. Furthermore, [the gas pipeline] wouldn't be under the FERC's jurisdiction; rather, it would be under the RCA, the processes for which seem reasonable and appropriate. He posited that the statutes related to "intrastate" may be burdensome and complex. Although Mr. Heinze said he reserves the right to suggest a revision to the language in the future, he stressed that on an intrastate basis, Alaska is in reasonably good shape.

MR. HEINZE informed the committees that the concept of the ANGDA as a state-owned gas transmission company functioning as a utility will offer a tremendous "cost to service" advantage to Alaskans. However, that doesn't mean that the ANGDA wouldn't go to a company such as the ENSTAR Natural Gas Company to design, build, and operate something. Still, when one looks at the state as an owner/financer of this type of project, [the ANGDA] is very attractive. He relayed that in working on this matter, it has been determined that there is a "bullet line" concept that could be adopted [to address a Cook Inlet gas shortage], though this idea has not progressed to the point of determining a specific [route/location].

MR. HEINZE added that a bullet line, as is implied, means that the line goes as directly as possible. One logical route is to follow the Trans-Alaska Pipeline System (TAPS) right-of-way to about pump station 7 and then move cross country as straight as possible, and go by McKinley Park. He mentioned the possibility of a bullet line following TAPS down to Delta and taking the turn with TAPS to Glennallen on down to [Cook Inlet]. He emphasized the need to conceptualize a pipeline that delivers a fairly sizable volume of gas to this area.

MR. HEINZE reminded the committees that there is already a policy specifying the need to make the gas available in Alaska. However, there are two basic threats to that policy through the current system. One threat is the physical ability to take gas off. Mr. Heinze suggested that prior to any open season, the

legislature should set a basic condition that some locations be specified as to where some gas will be taken off. He said that if the legislature can't get an entity interested in building a pipeline through the common land to [submit a proposal specifying take-off points], he would do it if the legislature appropriated money for that purpose.

CHAIR OGAN opined that it makes good business sense for any company building a pipeline to make as much gas as possible available to local residents.

MR. HEINZE turned to the issue of tariffs, and noted that because this is an interstate gas pipeline, [the ANGDA] has no control over intrastate tariffs; rather, the FERC does. If there are multiple drop-off points under the system, there's no guarantee that the tariff will reflect the fact that the gas wasn't transmitted all the way down. For instance, it might cost $2.39 to take the gas off anywhere in Alaska, which is the same as taking it to Alberta. Therefore, Mr. Heinze suggested that as part of the Stranded Gas Act, one of the conditions should be a "distance proportion" tariff requirement within Alaska such that a tariff to the border has to be set and, thus, if [the gas] only goes halfway to the border, only half the tariff is collected.

CHAIR OGAN commented that the aforementioned makes good business sense.

MR. HEINZE said, "As an Alaskan of many decades, I am not prepared to trust this issue to an agency in Washington, D.C." He went on to note that the argument is that the millions of consumers in the Midwest shouldn't have to subsidize the delivery of gas to the few thousands of customers in Alaska, and such an argument might resonate in Washington, D.C.. He said that there's an easy way to deal with this issue through the fiscal terms of the Stranded Gas Act. He reiterated his belief that when the legislature faces a contract, it should consider including a "distance proportion" tariff requirement within Alaska.

MR. HEINZE turned to the "open season" process, and informed the committees that one of his responsibilities is to think about how to make the LNG project interact in a positive manner with the highway project. One of the keys to designing the LNG project is to determine the gas composition. He emphasized that he has no knowledge of the gas composition on which the pipeline design was based. The aforementioned isn't public information. The informational issue is extraordinarily important because the legislature is going to have to make a multi-billion dollar decision on the Stranded Gas Act contract. He stressed the need to check the information, at least at some level.

MR. HEINZE posed a situation in which there is a 120-day open season, which, if it started in June, would mean that the 120 days would expire during the legislature's interim. Such a situation would potentially require the legislature to be called in for a special session. Mr. Heinze opined that the concept of a fair and equitable "open season" process would ring truer if there was more disclosure. He offered his belief that the committees could've asked Agrium Inc. what it's process would be in terms of due diligence in making a major commitment during an open season period; he acknowledged, however, that such wouldn't happen quickly. "The more prepared we are, the better this can work," he added.

MR. HEINZE turned to the access issue with the LNG project. At this point, there hasn't been much discussion regarding market access because people assume that the market is there. However, that's not the case with LNG because LNG has to have a place to go. The place "we logically want to go" is the West Coast. He showed the committees a map from the FERC that notes proposed [facilities], many of which would be in the Gulf of Mexico. Although the "lassiez faire" approach by the FERC seems to be working, he opined, there is concern that of the many proposed [facilities] on the West Coast, only one of those may occur in the U.S. under the FERC's jurisdiction. Furthermore, if that proposed [facility] is proprietary, Alaska LNG could be "locked out on this." He noted that he has raised this issue with the FERC and he raises it today because he believes it's an issue that should receive some thought.

CHAIR OGAN recalled the Energy Council meeting in Alabama where when driving east of Mobile, about every fifth house had a sign in its yard saying "No LNG". He commented that he felt right at home, and further commented that there are people everywhere who don't want anything built. Therefore, one of the topics of the Energy Council has been in regard to how to site an LNG plant because of the resistance to

it. Now the only place folks are thinking of building LNG plants is offshore, where there would be major security issues.

MR. HEINZE agreed with Chair Ogan. He then noted that he didn't discuss the East Coast because of the number of proposals is modest while the resistance is very high. He characterized the aforementioned as a local struggle. However, he reiterated that the good news is that the offshore opportunities are in the Gulf of Mexico, whereas the West Coast is always going to present a difficult situation.

CHAIR OGAN commented that the Gulf of Mexico is a fairly mature oil province, and therefore one would think there wouldn't be as much resistance. "America is going to have to wake up or start paying a lot more money for gas; same thing ... for the Cook Inlet," he said.

MR. HEINZE returned to the map and explained that the blue arrows show the LNG coming in. In wrapping up his presentation, Mr. Heinze recalled Senator Bunde asking, at another meeting, whether any other states involved with [gas pipelines] get involved with tariff and access issues. The State of Wyoming [under the] Wyoming Natural Gas Authority is one such example.

MR. HEINZE continued, "[tape begins midspeech] ... if you'll drill more wells, I'll build a pipeline to you," adding that the aforementioned dialogue occurs around the world. He returned to the topic of the "Alliance pipeline," which was built because a bunch of producers broke the deadlock and took the risk of building a pipeline. In Wyoming, the state has decided that it was losing so much money from the royalty in Texas that it decided to step in. Therefore, within the last few years, the Wyoming Natural Gas Authority was activated. [The Wyoming Natural Gas Authority's] bonding is $1 billion to build pipelines in order to "de-bottleneck" its gas.

MR. HEINZE said the tariff difference from the world price has been well over $1.00 because of the difficulty of getting from Wyoming to the marketplace. The objective is to drive that number down to $.50. Therefore, every unit of production is going to be worth more. Additionally, the pipeline capacity will be expanded so that the take out for Wyoming is increased from 4 bcf to 6 bcf a day. He commented that Wyoming is a very conservative place, and that he didn't believe the state receives any federal money for education so that the federal government can't be involved in how the state runs its schools. Mr. Heinze said that the Wyoming model will be reviewed and explored.

SENATOR SEEKINS offered his understanding that during the time when a gas pipeline is built, the FERC decides how risky the pipeline is and specifies that the [entity] can make somewhere between the guaranteed return on the ownership of 12-14.5 percent. He asked if the cost of financing is part of the capitalized cost of the return.

MR. HEINZE explained that pipeline financings are done in a "debt equity" structure. For example, if the debt is 70 percent and equity is 30 percent, then for tariffs, whatever the bond rate is [on the debt] can be included as a cost; in other words, what is paid in interest is a cost and becomes a component of the tariff. Another component of the tariff pertains to how many dollars of equity there are and what is allowed to be earned on that equity, which is the 12-14.5 percent.

MR. HEINZE said that in a "cost of capital" sense, it's reasonable to use a 70:30 percent [debt to equity ratio] with a 12 percent return on the equity and 8 percent on the debt. For smaller projects, such as a spur line, [the ANGDA] is looking at 100 percent debt, which is typically how a local utility would do it. On a 100 percent, there is the potential for a low interest rate. "That's why I'm able to show you some numbers that indicate that our cost of service would be a lot less than other people; now, I'm not making that claim in [regard] to a $20 billion project or even a $10 billion project, but I am as far as smaller projects that are more Alaska-sized," he stated.

SENATOR SEEKINS surmised, then, that a company with a lot of cash could leverage "pledging," receive a low interest rate, and roll it into the tariff.

MR. HEINZE said that traditionally, a pipeline company favors using a higher percentage of debt if it can be obtained without materially increasing the debt rate. Oil companies, on the other hand, tend to be very equity oriented, and perhaps would structure it at 50:50. He predicted that the state would probably aim for 90:10 because the state isn't oriented toward the return on the investment as much as it is oriented toward getting the lower cost of service.

SENATOR WAGONER turned to the "bullet line" option and asked about timing, the sizing, and the capacity of it [with regard to] handling the needs of the entire Cook Inlet basin.

MR. HEINZE proposed a scenario in which the [bullet line] started at Point Thompson with a 24 inch line that is laid down over the TAPS right-of-way, which would be followed down to Delta and then over to Glennallen. Such a line could easily be designed to handle a half billion cubic feet a day if not a billion cubic feet a day. He pointed out that by going down the TAPS right-of-way, there is a pad, gravel, and access. The desire would be to keep it as simple as possible, and such a system could be built fairly fast because the lead times for procurement wouldn't be too long and only a couple construction seasons [would be necessary]. With regard to the question of [completion] by 2008 or 2009, he said he didn't believe [such was possible], nor did he believe [the legislature] would be wiling to make such a decision in the next couple of years.

MR. HEINZE informed the committees that he was one of the reviewers of the Department of Energy study discussed by the ENSTAR Natural Gas Company yesterday, and although the study concludes that the exploration potential is there, he relayed his concern with a scenario in which nothing happens within the next two to four years. If the aforementioned happens, then something like a bullet line would be a solution if other things haven't progressed. Mr. Heinze specified that his concern is in regard to dealing with the Alaska issues in a wide variety of scenarios because there are various ways that this could play out.

MR. HEINZE added: "If nothing is happening in a few years and if this area is not finding gas, we better figure out something because, again, I've sketched through the alternatives [and] none of them are pleasant." One of the alternatives would be to build coal-fired power plants because there is a lot of coal in the area. Another alternative would be to resurrect the "Susitna Hydro Project." And, yet another option would be to import LNG from Indonesia. Mr. Heinze explained that the ANGDA's concept of the bullet line is to make sure there is a fallback option that makes some sense in Alaska and under Alaska jurisdiction.

SENATOR SEEKINS returned to Wyoming's situation and relayed that in talking with a Senator from Wyoming he was surprised to learn how much of the natural gas infrastructure deals with coal bed methane and its transportation. He offered his understanding that about $1 billion a year is brought into the state treasury from coal bed methane. He asked whether that's part of the reasoning behind Wyoming's increase in marketing.

MR. HEINZE pointed out that Wyoming has a lot of stranded gas that can't be gotten to market because there aren't enough pipelines going out. Furthermore, the pipelines in the area are already full. Therefore, the options are to build new interconnects or do something to "de-bottleneck" the system in order to address the transportation issue. The billion dollars worth of bonds is in reference to "de-bottlenecking" the system and making it more attractive [by] lowering the shipping charge and increasing the volume.

MR. HEINZE said that with regard to the coal bed methane, Wyoming was probably the major coal producer in the U.S. several decades ago. Due to the decline of coal being used for electric power generation, Wyoming has seen [coal production] wane. Still, there is probably a huge coal resource base and parts of Wyoming have determined that they can utilize that resource base through a coal bed methane approach rather than an open pit mine. He noted that Wyoming also has very large conventional oil and gas resources. The gas resources were only found recently due to their depth. He mentioned that at this point, there are estimates that Wyoming was losing $135 million worth of taxes and royalties because the gas was stranded. There are also estimates that with the improvements through the pipelines, the state would realize additional revenues in the amount of $500 million a year.

SENATOR WAGONER emphasized that if gas isn't taken to Cook Inlet by 2009, or more gas reserves aren't discovered, the economy of the entire Cook Inlet Basin, including Anchorage and the Mat-Su Valley, will be in trouble. Without cheap gas, the entire economic wellbeing of Southcentral Alaska is at risk. Senator Wagoner posited that Alaska has the cheapest natural gas in the U.S., but that will change if care isn't taken.

MR. HEINZE said that all the factual information that he has supports the anecdote that [Southcentral Alaska] grew largely on the basis of cheap energy. However, that's over and the problem is that the supply situation could be worse than the price situation.

CHAIR OGAN expressed the need to have someone discuss the costs to off-take gas out of the pipeline. Chair Ogan announced that he was going to ask [Legislative Legal and Research Services] to review the state law in regard to ensuring Alaskans access to the gas.