Stranded Gas Hearings

(0409011045 Minutes)

State Bonding to Build Pipelines and Buy Pipeline Capacity – The Wyoming Experience

Bryan Hassler, Executive Director, Wyoming Natural Gas Pipeline Authority (WPA)
Geoff Urbina, George K. Baum and Company, September 1, 2004.

Goals:

> Reduce the price differential for all Wyoming-produced gas to historic levels of $0.50 or less.

> Increase the market for and market access to Wyoming-produced gas by 2 Bcf/d in the next four years. (Currently produces 4.2 Bcf/d of which 4.0 Bcf/d is exported.)

Mission:

> Advance and facilitate all industry sponsored and supported projects.

> Proactively promote infrastructure development within the state and Rocky Mountain region.

> Promote efficient utilization of existing infrastructure in a cost effective manner.

> Promote development of Wyoming's mineral resource base in a systematic, streamlined and environmentally responsible manner.

> Utilize $1 billion bonding authority to build or cause to be built infrastructure projects that will enhance state netbacks.

> Promote development of an energy resource base that is in the nation's best interests.

MR. HASSLER said:

Based upon what you see in the "potential gas" committees' study and National Petroleum Council studies, you need every bit of gas that you can produce, not only in the Lower 48 and development of the resource base within Wyoming, but you also need Alaska natural gas and LNG imports to make this country ... grow as it has in the past.

MR. HASSLER explained that the WPA is a corporate body within the guise of the state, and therefore the WPA is an independent body that is legislatively mandated. However, the WPA isn't a body within the political infrastructure within the State of Wyoming, and this is critical with regard to state investment in internal improvement projects. The WPA was established in July 1, 1979, after the giant over-thrust fields were discovered, and Wyoming had limited infrastructure in terms of moving production out of the state. The purpose of the WPA is to plan, finance, construct, develop, acquire, maintain, and operate pipeline infrastructure within and without the state of Wyoming. One of the major attributes of the WPA is its $1 billion bonding authority. "We can move a tremendous amount of gas over relatively short periods, ... at a very attractive tariff and a billion dollars of bonding authority if we were to serve as a conduit financer for a number of projects in development, [and] would develop probably three or four ... projects under a traditional 'debt to total capitalization' type structure," he highlighted. He reviewed the other major attributes of the WPA, as specified on pages 3-4 of his written testimony [original punctuation provided]:

- Use of bond proceeds immediately after the sale of the bonds rather than after completion of project construction.
- Permits the Authority to sell or lease capacity.
- Statutes allow the Authority to lend the bond proceeds to other parties.
- Authority can charge fees for the use of Authority's facilities including pipeline capacity.
- Authority can conduct hearings to obtain data, identify markets for Wyoming natural gas and be an advocate before FERC.

- Statutes allow the Authority to acquire natural gas supplies to fulfill its capacity commitments.

MR. HASSLER pointed out that some revisions were enacted in Wyoming's 2004 legislative session. Those revisions are as follows:

Provides the Authority access to pipeline capacity for its own purposes.

Permits the Authority to have an undivided interest in pipeline assets.

Allows conduit financings by the Authority.

Clarifies the purchase of the Authority's bonds by the State treasurer.

MR. HASSLER reviewed the similarities between the Alaska Natural Gas Development Authority (ANGDA) and the WPA by paraphrasing from the following written testimony [original punctuation provided]:

Similarities:

1. Both the ANGDA and WPA were established to promote the development of their respective State's natural resources.
2. Each was designed to be self supporting.
3. The Authorities can take an ownership interest in a project.
4. Each Authority can issue both tax-exempt and taxable bonds.

Differences:

5. WPA does not need legislative approval to issue bonds.
6. WPA is limited to $1 Billion of bond authorization.
7. WPA can not provide a moral obligation pledge.
8. WPA operations are funded by a state loan.

SENATOR THERRIAULT asked if number four in the above-specified differences refers to the WPA's yearly operating expenses.

MR. HASSLER explained that the original loan to the WPA was approximately $280,000, which was granted in 2002. The board operated without any permanent staff until last May when he was hired. He emphasized that [the WPA] has been very conscientious in terms of where money has been appropriated and how that money has been utilized. In the last biennium, the legislature authorized the issuance of another $1.7 million loan to the WPA [after reviewing] the WPA's carefully prepared budget, which specified what projects it was reviewing, the resources the state might have, and the incremental increase of staff necessary to put together pipeline infrastructure projects inside and outside of the state.

MR. HASSLER said that the WPA intends to be self-supporting and pay back the loan the state has given it. He clarified that the WPA has five years to pay back the loan, which was issued with a 4 percent [interest rate], and explained that part of the reasoning behind [the State of Wyoming] loaning the WPA money and allowing it to be a body corporate is that it allows the WPA to have a direct investment in the pipeline infrastructure projects while simultaneously promoting such projects without circumventing constitutional issues within the state.

MR. HASSLER returned to his presentation and highlighted the pictorial map on page 6 of his written testimony. He explained that the numbers in the circles represent a potential recoverable resource base. He highlighted that Opal, Wyoming, is a major supply hub with approximately 1.5-1.7 bcf through three to four plants that are active in that area of the state. As the pictorial illustrates, the bulk of the pipeline infrastructure within the Lower 48 is built to access Texas, Oklahoma, and Louisiana in order to move those gas supplies into the Midwest and the East. The pictorial also illustrates the major trunk line out of

Alberta, Canada, which is associated with the NOVA system, TransCanada systems, and the Alliance pipeline. "When you look at infrastructure within the west, it's very anemic for the potential resource base that you see here," he highlighted.

MR. HASSLER turned to the question of why one would establish an authority. The Governor of Wyoming has said that the WPA [should be established in order] to develop the resource base within Wyoming and help [the state] achieve pricing parity with other portions of the country. Mr. Hassler relayed that over the last few years, the largest problem Wyoming has faced is low gas prices, which were due to growing supplies and lack of pipeline infrastructure to move gas supplies out of the state and the region. As the [graph on page 8 of WPA's written testimony] illustrates, in 2002 prices dipped on a monthly basis at close to $1. In the winter there is some pricing parity with the NYMEX [New York Mercantile Exchange] equivalent because of the tremendous swings in terms of the utilization of gas within the Rocky Mountain states. For instance, Denver consumption in the summer averages 200-250 million cubic feet (mmcf) a day. However, on a peak day in the winter, Denver consumption can reach in excess of 2.5 bcf a day. The Salt Lake City market has similar characteristics. Therefore, consumption with the Rocky Mountain states increases in the winter, which limits the need for pipeline export capacity. He noted that during the summer of 2002, there were daily reports of prices of less than $.25 mmcf on certain days, when there were constraints on the existing export infrastructure.

MR. HASSLER turned to the question of the cost of the limited infrastructure to Wyoming and mentioned that it amounted to $130 million-plus in federal and state royalties and severance taxes in 2002. He reminded the committees that in 2002, the NYMEX prices were much lower compared to today's prices. In March of 2003, the "opportunity cost" due to the lack of export capacity from the region approached $1 million per day. Furthermore, the cost of limited infrastructure led to stalled investment in development of mineral resources because producers can't be attracted to a resource base that has very little value. From the State of Wyoming's standpoint, low prices and the lack of development of the resource leads to limited ability to predict revenues with certainty and fund those projects the state finds necessary to fund. Moreover, growing supplies in Wyoming also lead to the need for export capacity. He pointed out that the graphs on pages 11 and 12 illustrate what is happening in Kansas versus Wyoming, and Oklahoma versus Wyoming. The graph on page 11 illustrates that Kansas production has declined by almost 1 bcf a day over the last 10 years, while over that same 10-year period, Wyoming production has increased by over 2.3 bcf [as illustrated on the graph on page 12]. The graph on page 12 further illustrates the loss of productive capacity in Oklahoma, which, over the last 10 years, amounts to almost 2 bcf a day. Therefore, there is a real need for incremental supplies to backstop declining production in some of the most productive areas of the country. Wyoming's 2.3 bcf a day is representative of Wyoming's productive capability over the last few years and of the need to develop incremental export capacity.

MR. HASSLER then addressed the critical success factors for resource development. He explained that the study the WPA performed last year attempted to illustrate what limits markets from entering and requesting incremental capacity to access a cheap, long-lived, reliable supply resource base. The study further looked at what limits producers from making commitments to incremental pipeline capacity to fulfill long-term capacity commitments and continue to develop, grow, and explore the land base. He informed the committees that access to lands in a timely manner is a critical function associated with producers stepping up with capacity, especially in a state such as Wyoming that is heavily endowed with federal lands and [considers] the environmental impact associated with assessing the impact of oil and gas development on those federal lands. There has been a tremendous lag in the development of the resource base because of the environmental impact, he noted. Mr. Hassler pointed out that price, timing of regulatory approvals, gathering system capacities and pressures, transportation export capacity, capital efficiency, and public acceptance are all variables that can limit or accelerate the development of pipeline infrastructure as well as the resource base.

MR. HASSLER continued with [page 14] of his written testimony, which is a schematic that illustrates pipeline capacity moving out of the State of Wyoming, which consumes about 200,000 mcf a day within the state and exports about 4 bcf a day in natural gas produced outside of the state. Therefore, Wyoming is not a consumer of natural gas but rather an exporter of natural gas. He highlighted the Kern River pipeline, which was initially put in place in 1992 and allowed for export of natural gas supplies to California. That original pipe had roughly .9 bcf a day in capacity. In May of 2003, the Kern River pipeline was "looped" and was able to provide for export of almost an additional 1 bcf a day of supply from the state. The schematic also highlights the El Paso Cheyenne Plains project and the WBI [Winston Basin] Grasslands project, which Mr. Hassler reviewed for the committees.

SENATOR LINCOLN recalled that one of the critical success factors was public acceptance and access to the lands. She asked if any of the lands are Indian lands.

MR. HASSLER answered that the central portion of Wyoming, the Wind River Basin, has a large reservation, and , as the pipeline moves into Montana, there are Indian lands there as well. In further response to Senator Lincoln, Mr. Hassler specified that the individual producers with concessions negotiate the provisions regarding access to those lands for oil and gas development activity. Pipeline companies that want to move those supplies [on Indian lands], in conjunction with the producer, will negotiate with regard to how those supplies will be moved.

SENATOR LINCOLN asked whether the ability to access the gas could be one of the provisions that the tribes request.

MR. HASSLER replied yes, but noted that there is very little industrial activity within Wyoming. Therefore, he suggested, most of the natural gas and crude oil discovered and produced from tribal lands is looking for a market elsewhere, and, thus, [the tribal entities] are probably seeking to achieve the highest export price possible for the product developed on those lands.

MR. HASSLER returned to his presentation and highlighted that Wyoming is endowed with many existing and developing pipelines out of the state. Once El Paso Cheyenne Plains is "in project," Wyoming will have promoted almost 3 bcf a day of export capacity from the state. He then turned attention [to the graph on page 15 of his written testimony], which illustrates the spread between NYMEX prices at $9.00 and Wyoming prices at $5.00 that narrowed substantially once "gas on gas" competition within the region is eliminated and the capacity is exported to the market. Mr. Hassler moved on to the revenue facts [as specified on page 16 of his written testimony]. He informed the committees that Wyoming receives 50 percent of the royalty on gas produced on federal lands, and approximately 75 percent of the lands in Wyoming are federal lands. Wyoming also receives approximately 7 percent of the value received from all production of the state from a severance tax assessment. He noted that he hasn't included the value of royalties from state lands, which amount to two sections per township and range, and value created by ad valorem taxes. He explained that he's attempting to illustrate what developing incremental infrastructure within the state can do for the state from a revenue standpoint. Mr. Hassler provided the following [written] example:

> Wyoming receives 50% of Federal Royalties = approximately 6.25% of Federal lands. Assume 100% of production comes from Federal lands.
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> Wyoming receives approximately 7% of the value received from all production in the State from severance tax assessment.
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> Wyoming's current saleable production is approximately 4.2 bcfd.
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> Wyoming's revenue share of production is approximately 4.2 bcfd X (.0625+0.07) = 556,500 Mcfd.
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> At gas prices of $2 per MCF, Wyoming could expect to receive $1,113,000 per day in natural gas revenue. At $4 per Mcf, Wyoming could expect to receive $2,226,000 per day.

MR. HASSLER noted that if a 7 percent ad valorem tax is included, the state has ownership value in excess of 20 percent of the production.

SENATOR HOFFMAN inquired as to the life expectancy of the gas in Wyoming; that is, "How long do you see between $1 and $2 billion?"

MR. HASSLER referred back to page 6 of his written presentation, which refers to 170 trillion cubic feet (tcf) a day, and informed the committees that "we" are producing approximately 1.3 tcf a year from the state. At existing production rates, there's a 170-year reserve life. Mr. Hassler offered:

> To get into an efficient cycle, we believe that because of the tremendous resource base, if we can get access to lands, get producers to develop the resource base in an environmentally responsive manner, ... there's a very real thought process that we can grow production from the state substantially, relative to where it sits today. As I indicated, we think we can go from 4-4.2 bcf a day to 6 bcf a day over the course of five years if ... we are successful in promoting the resource in an environmentally responsible manner and ... working with the environmentalists in terms of developing that resource base.

MR. HASSLER pointed out that if Wyoming's resource base is reviewed relative to where Alberta, Canada, is, Wyoming could be able to produce 10-12 bcf a day of natural gas resource over the next 10 years. However, some of the resource sits in environmentally active areas in which there are problems with regard to surface access and water discharge. Mr. Hassler returned to [page 17] of his presentation and highlighted projects that the WPA has reviewed [and which are being forwarded], such as the Cheyenne Plains Project, the Jackson Hole Project, and the Rock Springs Project. He relayed to the committees that the WPA has found that before such an entity "swings for the fences" it would be appropriate to get the investment banking team and the bond council working on a smaller project with which it can work through any difficulties in terms of issuing bonds. The Rock Springs Project is such a project for Wyoming.

GEOFF URBINA, George K. Baum and Company, informed the committee that for the Halliburton Rock Springs Project, it will be the first financing for the WPA, and the project is a "taxable lease" revenue bond. [Referring to page 19 of the WPA's written presentation], he indicated that the WPA will be involved in this project by issuing bonds to do the take-out financing. He explained that with this project, a limited liability company (LLC) signed a lease with Halliburton, and a short-term construction loan was taken out with permanent financing. The aforementioned, he noted, is typical of pipeline financings that are performed in the corporate world. The only difference is that this is lease revenue as opposed to revenues resulting from a tariff or shippers selling gas to the end market.

MR. URBINA turned attention to page 20 of the WPA's written presentation, which reviews state financing tools available to build pipelines. With regard to the option of conduit financing, Mr. Urbina pointed out that such financing was used to build the marine terminal for the Trans-Alaska Pipeline System (TAPS) in Valdez. The City of Valdez issued the bonds for the aforementioned project. With the Halliburton project, the [Wyoming] state treasurer was involved as an investor of the bonds. He noted that Wyoming has the Mineral Trust Fund, a fund similar to the Alaska permanent fund. The [Wyoming] state treasurer considered the Halliburton Rock Springs Project worthy for many reasons, including [the ability to purchase the bonds at a competitive rate]. Furthermore, this project develops a tax base in Rock Springs, which he characterized as a boomtown.

MR. URBINA highlighted the state financing tool of a "stand-by bond-purchase" agreement. He explained that such an agreement can occur when there is no market for the bonds, and the state can purchase/hold the bonds while the bankers try to find a market for them. The aforementioned is a way in which the state can provide liquidity or credit.

MR. HASSLER interjected that constitutionally, Wyoming can't provide certain [financing tools]. The State of Alaska will have to determine what fits [for Alaska].

MR. URBINA indicated that [the stand-by bond-purchase agreement] has been performed under the state umbrella. He then turned to the debt service reserve fund (DSRF), which he likened to a parent co-signing for his/her child's automobile. Ultimately, the financial institution will come after the DSRF if there is a default on the bonds; this is similar to when in-kind state/federal gas is used or there is a moral obligation pledge. Mr. Urbina turned to the option of state ownership of the [pipeline], which is the riskiest and should be reviewed on a number of levels [as specified on page 21 of the WPA's presentation]. If the state were to be involved in financing a portion of the pipeline or buying capacity, then 25-50 percent of the RIK revenues go to the permanent fund while the remainder goes into the general fund. There could be "opportunity costs" related to the [portion going into the general fund] because the legislature may want to fund other projects.

MR. HASSLER summarized that [the WPA] is serving as a common conduit to promote development infrastructure within and outside of the state from a natural gas and resource development standpoint. However, he noted that [the WPA] has the authority and ability to propose pipeline projects in the event that industry doesn't come forward and get the job done.