Stranded Gas Hearings
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Economic Impacts of Alaskan Ownership of an Interest in an Alaska Natural Gas Project
Ken Thompson, President and Chief Executive Officer, Pacific Star Energy, October 14, 2004.

MR. KEN THOMPSON, Pacific Star Energy, gave the following presentation.

> What I'd like to talk about now, really it is a different hat - before I talked about - was asked to talk about the capital allocation as a past, retired executive of ARCO. Now I just want to talk as an entrepreneur in Alaska and about a start-up company called Pacific Star Energy. What I really want to show is the results of the first ever-quantitative socio-economic study of the impacts on Alaska if Alaska companies, whether it's Pacific Star Energy or different companies, if Alaska companies can have ownership. If Alaskans have the chance to have a mechanism to invest themselves, what kind of impact would that mean over the next two or three decades? ... I'll talk about the vision of Pacific Star Energy. I'll talk about our value added proposition - what we think we can bring to the table working with producers or pipeline companies in the state. And then most importantly, we'll share the results of an economic impact of Alaska company ownership in the natural gas industry and that was prepared by an outside consultant, Northern Economics Incorporated here in Anchorage. And we asked them to say what if that 10 percent was owned by a company in Houston or London versus what if that 10 percent was owned by a company here in Alaska. What is the difference? Many benefits accrue regardless of who invests. There is a difference if some ownership stays here and I'll talk about the implications of that and recommendations.
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> A little bit about the vision of the company. We started two years ago and PSE, the way we look at it, will become an integrated natural gas consortium of Alaska. Our goal for the next few years is to have a 10 percent interest in any North Slope gas pipeline project to Alberta or a 20 percent interest in the North Slope gas pipeline from the slope to the Alaska Canadian border. You heard yesterday, I believe it was Lehman Brothers or perhaps it was UBS that talked about financial instruments in a master limited partnership way of investing that it may make a difference on the ownership for us whether we go into the Canadian segment or not.
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> Importantly though, we are one of the only companies talking about what we'd do with cash flow from the pipeline. Our vision would be - and I used to manage these businesses for ARCO years ago in the Lower 48 - we would take one-half of our cash flow of our share of the gas line and distribute back to our shareholder owners, individual Alaskans, Alaska companies. The other half of the cash flow, our business plan calls for reinvesting in the state and the different ways would be in hub gas distribution centers, one near Glenallen, for example, and also we are interested, like the Alaska Natural Gas Development Authority and we're working cooperatively with them, for example, on spur lines into Anchorage by 2015 to supply gas here as gas declines from the Cook Inlet.
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> We also are examining interest in natural gas processing. We would see taking part of the gas liquids, like propane and butane, for distribution in Interior communities, as well as Southeast Alaska. And we're not ruling out niche petrochemicals. We have done some work on that. That's a tough one to make commercial in Alaska, although we are continuing to examine small scale. In other projects, I've looked at very large scale and have not been commercial or competitive. We're taking a look at just niche petrochemicals down on the Kenai Peninsula that could be readily shipped to the West Coast.

REPRESENTATIVE CROFT asked for an example of a niche petrochemical.

MR. THOMPSON replied, "Right now one that we're looking at would be - we would spur a pipeline into Anchorage that would tie into the Enstar system. It would also allow for additional gas distribution as the Cook Inlet declines down to the Kenai Peninsula. We would build a small niche petrochemical plant there that would mainly manufacture ethylene and then polyethylene resin - it's a feedstock for plastics that could then go to other chemical plants in Asia. Although that's a very small part of our business, it would be something into the future.

MR. THOMPSON continued his presentation.

Near term, a percentage interest ownership in the gas pipeline - in fact, if the state does not own 12.5 percent equity ownership, we would gladly take any percentage that you don't take. So if you don't take the 12.5 percent, we will. At least that money would stay in Alaska. If you take 6.25, we'd be happy in pulling together Alaskan investors to invest in all 6.25. That's what we're essentially looking at. We were very pleased to be brought into the consortium with MidAmerican Energy. MidAmerican Energy owns just over 80 percent and we were pleased to be brought into their consortium this past year as a just under 10 percent owner and then CIRI is also a part owner, just under 10 percent.

We wouldn't rule out, first time ever, it might be a miracle, but 2017 our vision calls that on the North Slope, could you imagine for the first time ever, an Alaska company actually owns gas production. Right now gas production - there's no equity ownership - a couple of Native corporations have royalty ownership in the oil and gas but not one Alaska independent owns in that so we have maybe fully integrated in the future through cash flow from the pipeline to plow it back into the North Slope and perhaps acquire or explore for natural gas.

This is just a schematic - slide 4 - of what we'd do. We would have ownership in the main gas line down to a hub near Fairbanks, Delta Junction and, of course, the gas line would go on to the Lower 48. We'd hope for 10 percent interest in the yellow that you see there. Then we would own a majority interest, potentially even operate the hub. Hubs are very common in the Lower 48. They're more trading hubs while this would be, to some degree, a trading hub but much more of a mechanical hub to then get gas moved into spur lines to Fairbanks and on to Anchorage. We're looking at supplying utilities for power generation and then if entrepreneurs feel like an LNG project of a smaller scale can be commercial out of Valdez in the future, we certainly would want to look at participating in any spur line that went to Valdez.

Here's where we stand as far as funding and the game plan we can afford. We do see it as an opportunity for any interested Alaskan and that's one unique thing. In the past couple of years I've talked to the regional corporations - the Alaska Native Regional... [end of tape]

MR. THOMPSON continued.

[beginning of tape]...large companies, individuals that might be interested at one point.

Seed funding - I'm pleased to say that we have successfully obtained all of our seed funding through the end of next year. We were seeking that from the Native corporations. They have decided to do their own thing from their own consortium and within a month of that, and within a month of that being announced, I did obtain another investor that fully funded our company through the end of next year. We would approach additional investors, companies here in Alaska, individuals that are accredited, for funding to then get positioned so that if the federal government 18 month deal does come into effect at the end of next year and if the state fiscal package also had that same time constraint, hopefully everybody involved - producers, pipeline companies, go to that next phase that we call the business evaluation phase and, as Joe talked about, there [are] a lot of things involved in that - the detail project engineering to get final estimates, permitting the right-of-way, we would need substantially more money by that timeframe of 2006 to 8 and so we're looking for additional investors this year and next.

I would say that's a risky phase because, as you know, that could be - that's the business evaluation phase for a couple of years. During that phase, there could be a decision made not to go ahead with the line for different reasons. If that were to be made, that's a risky investment. So for the next phase of funding, we really are approaching companies or accredited high net worth individuals. However, when construction starts, we envision and are looking at ways and talking to different investment banking firms on ways for a financial instrument for any interest in Alaska to invest. So, if an Alaska family of three wants to invest one of their permanent fund dividend checks in 2009 and own a piece of the pipe, this could be a way to do it. This would also be an alternative mechanism that the federal government talked about in their legislation, at least for a percentage of the line.

When the line is underway, we see the risk as moderate or certainly lower because once construction starts, you do know the terms from the federal and state governments. By that time of construction you will have made gas contracts with customers on the other end. Hopefully you would have secured gas supply by that point. We would be very interested in helping transport part of the state's royalty gas for example. And then we're looking at the financial instruments, investment trusts, innovative mutual fund ideas, and actually we have also screened and are looking at master limited partnerships that you had heard talked about yesterday by Lehman Brothers. Warren Buffett used master limited partnerships on pipelines over the last few years - spent about $2.5 billion, and that's been his innovative financial instrument and that's one that we're also assessing.

We believe our company can bring something unique in the gas line. More profits stay within Alaska. That's a healthy state economy. By the way, this may be mind boggling to some, perhaps, 10 percent interest from the slope to Alberta, would create the largest revenue company in Alaska. And if a 12 percent return is made on that investment, it would also create the most profitable private company in Alaska. So, a 10 percent interest may sound small, but for Alaskan business, it is very, very significant and that's what interests us in this.

Also you have a company where profits stay here. I think that an argument can be made that helps the state economy and I'll show you in a moment. That perhaps could be a very significant way of lessening risk of producer tax increases. We would pledge on part of our cash flow to build markets, investments in in-state gas use and infrastructure. We can help on permitting, enhancement of Alaska hire obviously, and then help in government relationships and then it could be that we could play a role in helping also in pulling together minor producers' gas volumes for marketing or even the state's gas.

Slide 7 is an interesting one. It's the first time that we've shown it publicly because it is the conclusion of a report and I've got a more detailed copy of that. That shows with more details but bottom line we asked Northern Economics Incorporated if an Alaska company, whether it's ours or it could be anybody, say another group comes forward and offers a better deal to Alaska investors - we're not in the picture but another one is - this could also be an example of the benefits that could be made with state owning some equity ownership in keeping profits here. What we looked at, we asked Northern Economics what if that 10 percent is owned by an Alaska company versus that same 10 percent. Obviously, whoever owns any interest - there's going to be a lot of jobs, you've heard that, 10s of thousands of jobs in construction, permanent jobs numbering a few thousand potentially, and then there's a multiplier effect. We're not looking at that. That's already been reviewed with you in other testimony. We're just looking at the incremental additional benefits to Alaska if this time, for the first time ever, Alaska's companies had equity ownership. In TAPS, Alaska companies own nothing, nor on the oil. So this is a different example of we actually become and change the business model and Alaska companies play this time. And the incremental benefit is this. Northern Economics found that about over 35 years actually, $1.8 billion in profits, just for that 10 percent ownership, would be left within the state. From that would be over 22,000 incremental, part-time and full-time jobs, about 650 new jobs per year that otherwise would not be created if the cash left the state. Some of that, a small portion, comes from the spur pipelines or natural gas processing that our company would do but really most of that comes from the multiplier effect of cash being left with Alaskan shareholders and that's important to understand that as they spend their money on different things.

We're sharing with all of the unions in Alaska and that could actually mean $830 million incremental payments to labor and that is significant, above and beyond the normal impacts that would accrue from just the pipeline itself. Bottom line, it's $1.3 billion total value added to the state economy over 35 years and that, again, is over and above what a 10 percent interest owned by an outside company provides, is the way that they looked at it. That's important for a company, whether it's ours or to facilitate another Alaskan company or series of companies to have some ownership. The federal government has done that and I'll talk about it in a moment and we'd like to have the state legislature consider it as well.

Exactly what investment is needed to secure - and I did this just because the state is looking at a 12.5 percent interest. If our company did a 12.5 percent or the state, how much equity is needed that needs to be raised. If you run all the way from the North Slope to Alberta, the cost of that is $11.6 billion. Now that would save the state - our company doesn't own anything in the gas conditioning plant, that's a leased facility that will likely be owned by the producers, and it doesn't rule out state ownership but yet I'm saying the producers would own that. And then the state or even our company would own 12.5 percent from the Slope to Alberta. There would be equity capital of $435 million or $108 million per year. So basically, we would have to obtain equity capital through our investors for that amount by the timeframe of 2009. And you see the share of debt at about $1 billion. Again that would be debt secured and guaranteed by the federal government and that debt, in this case, would be owned by the pipeline company.

From the North Slope to the border, if the state only owned 12.5 percent of that, you'd have to come up with net costs of $750 million. That was the capital that we would also have to look at. That means equity capital of $225 million. By the way, all these assume 30 percent equity, 70 percent debt so if it's actually 20 percent equity, 80 percent debt, the equity amounts, of course, are 'ratioed' down.

So the sum means that we're trying to raise by about 2009 the $50 to $100 million per year from investors and through different financial instruments, or the state, if you took the 12.5 percent, these would be your numbers to raise by that time frame.

Bottom line, what's interesting is significant implications - is if you look back on slide 7, the last from the bottom bullet says $1.3 billion added to the state economy. In a way, if the state did in a fiscal package provide additional incentives, like Joe mentioned state incentives, perhaps for commodity risk protection, if the state were to do that, you're giving some value up. There's no doubt about it, you are. However, if the state owned equity participation or even if an Alaskan company like ours owned a participation percentage, through the additional incremental benefits to the economy, you can actually gain back much, if not all, of that value that you'd have to give up to get the project going. And these are the kinds of things that I'm sure Pedro Van Meurs and his team are looking at.

We would urge that similar to our federal delegation passing a Sense of Congress regarding encouragement of Alaska company participation, if you do a fiscal package next year, as an Alaskan, we would hope you'd incorporate identical intent of the legislature, just like Congress did for a Sense of Congress and I'll talk more about that in the closing slide.

And the bottom line, we see even a 10 percent ownership by Alaskan companies could add $1.3 billion to the state economy and 22,000 new jobs but we realize we have to bring additional value that I already mentioned.

So recommendations would be that the state and/or Alaska companies and individuals should own at least 12.5 percent of the gas line from the Slope to the border or at least all the way to Alberta to the marketing hub. And we would encourage you to include intent of legislature language and, by the way, what I've included in slide 10 comes out of the new military appropriations bill that Congress passed in the exact language. Congress passed a Sense of Congress that Alaska Native corporations and other companies owned and operated by Alaskans and individual Alaskans should have the opportunity to own shares of the Alaska natural gas pipeline in a way that promotes economic development of the state and then to facilitate economic development, sponsors should negotiate in good faith with any willing Alaskan person. We certainly have found willing Alaskan persons that are interested in investing in having ownership of the - and change the business model from the old oil business model. So that's my concluding remarks. I'd like to also mention that our company would also comply and would understand and if you put an 18 month timetable on the fiscal package and we had to do everything we could to make a decision to go to the next phase and raise money for that phase of permitting and detail engineering by 2006, we feel we can. And our business plan calls for compressing the three years of the detailed engineering and permitting from three to two and our goal is to start construction by 2009 and have first sales by the end of 2012. It's about a year longer than the MidAmerican proposal but about a year has passed since that proposal. With that, Mr. Chairman, that concludes my prepared comments.

REPRESENTATIVE CROFT asked:

Putting together some of the things that we've heard over the last day ... Exxon, BP and Conoco have limited capital resources and some internal reasons not to do it. Lehman Brothers and UBS talked about the interest that people have in investing in this outside of Alaska. You've talked about the interest that Alaskans have in investing in this. I guess, putting those all together, why should we wait for the producers? If non-Alaskans are interested, equity markets are interested, if there's reasons why the producers might not want to move as quickly as we want to and you're interested, why are we waiting?

MR. THOMPSON said as a start up company, even raising the 10 percent level of capital is a challenge. Pacific Star Energy is fully funded through next year with seed money. However, when the project moves into the permitting phase, the investment gets riskier. The cost could be $1 billion over two years, although he estimates $500 million. No matter the amount, Pacific Star Energy's share will be $50 to $100 million over two years and that is the riskiest part of the project. Pacific Star Energy's challenge is to find that money by the end of next year. He feels confident that can be done, knowing the interest of the financial markets. The Department of Energy will be arguing for a 14 percent rate of return. Investors want that. This would be a good hedge fund investment not tied to the stock market but tied to a relatively flat cash flow and a FERC regulated rate of return with loan guarantees. He said raising all of that money will require some big capital players. He added that if even two of the producers sign on, Pacific Star Energy would get its share quickly because that would bless the project by large, sophisticated investors. He noted the producers have the capital; the issue is how that capital is allocated as an upstream or downstream project. He pointed out that Exxon Mobil's upstream projects had a 30.6 percent return on capital employed, according to its annual report. He noted that he does not support a gas reserves tax because the producers are at the table negotiating in good faith and financial firms are interested in investing, so a gas reserves tax will cloud the water. He believes the state needs to create a fiscal package that will provide certainty for a number of years. He said the ball game was different three years ago when no one was sitting at the table.

CO-CHAIR WAGONER asked if the state considers taking an equity share in the project - possibly larger than 12.5 percent - that could have a detrimental effect on Pacific Star Energy.

MR. THOMPSON said that is correct. He predicted if the state took 12.5 percent and the producers and pipeline companies wanted the rest, it might be more difficult to allow Pacific Star Energy a small percentage. He said, "I would hope that good hearts prevail and that they would allow Alaskans a chance to invest so that men and women on the street that want to invest - but you are right, it could mean that we would be cut out of the picture and that's the way it goes."

CO-CHAIR WAGONER suggested the possibility that Pacific Star Energy could negotiate a percentage off of the state for investment purposes for state residents.

MR. THOMPSON agreed and offered:

What we have mentioned to certain individuals in the state is doing the Exxon case - like the Alliance Pipeline. If you remember, they took a large equity percentage in that large line from Alberta to Chicago to get it constructed and built and then later sold it off. Enbridge was one of the buyers. If the state took an interest, you'd get your payout and you want to hold it long term, keep it long term. If you want to get some of your cash back, you could divest and we'd certainly be interested in being in the bidding room to bid and buy back from the state after that. Then we would create the Alaska company.

Plan B, by the way, is even if we are cut out of the line because producers don't want us in or the state takes a larger percentage, our company still is interested and would pursue Plan B, which is the ownership and investment in some of the spur lines and even natural gas processing. But that's going to be more difficult because the way that we did in Plan A - to fund that stuff, is the stable cash flow from the gas pipeline percentage so we do a 10 percent, 12 percent return project there, stable cash flow, redeploy into more risky gas processing.