ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS
February 27, 2001
10:05 a.m.

MEMBERS PRESENT

Representative Scott Ogan, Chair
Representative Hugh Fate, Vice Chair
Representative Fred Dyson
Representative Mike Chenault
Representative Vic Kohring
Representative Reggie Joule

MEMBERS ABSENT

Representative Gretchen Guess

OTHER LEGISLATORS PRESENT

Representative Jeannette James

COMMITTEE CALENDAR

OVERVIEW OF STAGE 1 & STAGE 2 - ALASKA NORTH SLOPE LNG PROJECT SPONSOR GROUP

PREVIOUS ACTION

No previous action to record

WITNESS REGISTER

STEVE ALLEMAN, Sponsor Group Commercial Manager
Alaska North Slope LNG Project
PO Box 100360
Anchorage AK 99510
POSITION STATEMENT: Provided a Power Point presentation regarding the Alaska North Slope LNG Project.

GEORGE FINDLING, Manager
External Strategies
Sponsor Group
[Alaska North Slope LNG Project]
PO Box 100360
Anchorage, Alaska 99510

POSITION STATEMENT: Provided additional information regarding the Alaska North Slope LNG Project.

ACTION NARRATIVE

TAPE 01-17, SIDE A
Number 0001

CHAIR SCOTT OGAN called the House Special Committee on Oil and Gas meeting to order at 10:05 a.m. Representatives Ogan, Dyson, Chenault, Fate, Kohring, and Joule were present at the call to order. Representative James was also in attendance.

OVERVIEW OF STAGE 1 & STAGE 2 - ALASKA NORTH SLOPE LNG PROJECT SPONSOR GROUP

CHAIR OGAN announced that the committee would receive an overview of Stages 1 and 2 of the Alaska North Slope LNG Project Sponsor Group.

Number 0143

STEVE ALLEMAN, Sponsor Group Commercial Manager, Alaska North Slope (ANS) LNG Project, noted that he is a long-time Phillips Alaska, employee. He informed the committee that the ANS LNG Project consists of Phillips Alaska, BP Exploration (Alaska), Foothills Pipelines, and Marubeni Corporation. Mr. Alleman began by providing the committee with some background. He explained that this project was initiated by the sponsors in an attempt to develop an economically and commercially viable LNG project. After the passage of the Stranded Gas Act, ARCO solicited interest in 1997-1998 in order to form a sponsor group with the following working interest: Phillips Alaska - about 30 percent interest, BP Exploration - 26 percent interest, Foothills Pipelines - 25 percent interest, and Marubeni Corporation - about 19 percent interest. The sponsors completed an 18-month $12 million engineering design effort in August 2000, which was Stage 1. Now the focus has turned to the many ongoing issues of the commercial aspects for Stage 2. Therefore, he said he is present to update the committee on the past and ongoing efforts of this project.

MR. ALLEMAN turned to ANS LNG commercialization. He explained that it's about defining an economically viable project. That is, finding the right size for market entry, which was the focus of the Stage 1 efforts. Furthermore, [an economically viable project] would include innovative design in order to minimize

capital costs, which was the focus in Stage 1 and the continuing focus in Stage 2. Also, [there is the need] to minimize commercial constraints, which is where much of the discussion lies in relation to Stage 2. Finally, [there is the need] to test and rework the economic viability of the project. The commercialization of ANS LNG also [necessitates] the development, through parallel activities, to closing. After those things are done, the project would be constructed and ultimately, be in operation.

MR. ALLEMAN continued with a slide of the project basics from which he highlighted the guess that the project would purchase gas from the producers on the North Slope and build an 800-mile pipeline to either Valdez or Anderson Bay, or to Nikiski into Cook Inlet. At that point, LNG would be manufactured and shipped to market. The target markets would be Japan, Korea, Taiwan, and other markets.

REPRESENTATIVE DYSON inquired as to what Marubeni brings to the table.

MR. ALLEMAN explained that Marubeni is a Japanese trading company that does business throughout East Asia and the world. The [Sponsor Group] has a market liaison office established in their office so that all of the different markets can contact them and have a source specifically representing the Sponsor Group. Although Phillips and BP have offices and marketing efforts ongoing in the same countries, the [Marubeni office] focuses on the ANS LNG Project.

REPRESENTATIVE DYSON asked then if Marubeni is a wholesaler.

MR. ALLEMAN specified that Marubeni is primarily a trading company and hasn't been directly involved as far as an LNG seller. However, he noted that Marubeni is involved with other LNG projects around the world. He didn't recall those projects. Mr. Alleman returned to the Power Point presentation and informed the committee that Marubeni is working for the sponsor group in Tokyo. The updates are continuous [due to staff in Asia].

MR. ALLEMAN continued with the two fundamental elements necessary for Alaskan LNG to move forward: commercial viability and a market that's ready for gas from Alaskan projects. With regard to commercial viability, the project needs to be the right size so that it can obtain a toehold in the market and significantly advance projects. Furthermore, such requires

competitiveness with other projects trying to enter the market place. A market that is ready for gas from the new Alaska LNG project will require additional new demand, which will first be incremental expansions from the existing LNG projects and then the most competitive new LNG projects that can provide secure supply and can deliver when the market is ready.

MR. ALLEMAN turned to market analysis, which has been done in-depth. The first one was done for the Sponsor Group in 1999 and that was revisited in the spring of 2000. By the end of Stage 2, there will be another market assessment. As mentioned earlier, the initial target markets were Japan, Taiwan, and South Korea. Also, the emerging markets of China and India were reviewed. In Stage 2, U.S. and west coast Mexico markets will be reviewed. Mr. Alleman informed the committee that the market analysis reviewed, for each country, the following:

* Government initiatives in nuclear power capacity

* Competition from coal-fired versus LNG/gas-fired generation

* City gas companies' ability to displace with competing fuels

* Deregulation of electricity and city gas industries

* "Other" gas competition from potential pipelines

* Effects of independent power producers in a deregulated environment

REPRESENTATIVE DYSON inquired as to the impact of deregulation of electricity on the sale of natural gas.

MR. ALLEMAN pointed out that deregulation can vary. Generally, one views deregulation as allowing other market entrants into the marketplace. Therefore, [the analysis] attempts to gauge the impacts of deregulation in each marketplace. In general, Mr. Alleman felt that deregulation would be helpful.

MR. ALLEMAN continued with the Power Point presentation and the LNG market view, which he viewed as fiercely competitive. He showed a slide delineating possible market competition that summed 68-75 MTPA (million tons per annum) of LNG potential, including Alaska. The outlook for supply and demand is 20-40 million tons of LNG by 2010. The problematic trends are the

downward price pressure, and the shorter contracts and spot deliveries. Mr. Alleman related the belief that the Asian marketplace will continue as a long-term base supply, although there will be more pressure for more spot sales over time. Therefore, a smaller market entry reduces the market entry risk and provides [the Sponsor Group] with a better chance to get into the marketplace. The other competitor for ANS LNG is U.S. gas demand [through a Lower 48 gas pipeline]. He referred to the slide that had a bar chart entitled "2010 New Source Needs" in order to provide the committee with the magnitude of the various marketplaces.

MR. ALLEMAN moved on to discuss Stage 1, which included the development of the market entry project. Historically, [the Sponsor Group] had looked at 14-15 million ton market entry projects that would cost between $14-15 billion. However, a 7-8 million ton per year project was developed at $6.8 billion. He emphasized that the number was not just cut in half, but rather the project was completely redesigned to defer costs as needed, as well as minimizing any pre-investment cost. [The Sponsor Group] believes that this smaller size improves the groups' market entry probability and significantly reduces the capital cost and risk. However, the project remains expandable to a 14 million ton project if and as the market develops. Internally, the [the Sponsor Group's] mandate is to develop a project that could stand alone economically at a 7-8 million ton project, even if future expansion never occurs.

MR. ALLEMAN continued with a slide entitled "Key Area of Redesign." He informed the committee that the [the Sponsor Group] believes that it can begin with zero compression other than compression at the gas treatment facility and into the LNG facility. This, field compression, is an expense that can be deferred further out into the project and help economically. He pointed out that there would be two LNG trains that begin at 3.6 million tons. With Alaska's ambient temperature and other innovations, those can be expanded to 7 million tons each. After the redesign of the project, the ramp up illustrates how the ongoing risk of entering the marketplace is eliminated.

MR. ALLEMAN moved on to a slide entitled "Technical Data Base" pointed out that there was significant external input into the process through workshops that incorporated both external and internal experts and [both routes/sites advanced]. He noted that he is often asked why both routes/sites are [reviewed], to which he explains the need to develop a cost competitive project that can be done at either location. Furthermore, neither site

works if the overall project isn't doable. He noted that Stage 1 designing and engineering was done for both routes and sites. Keeping both routes/sites alive provides flexibility. With regard to the Nikiski site, it has the benefits of in-state gas sales to the existing markets [along the pipeline corridor], growth opportunities, and existing infrastructure. There is the opportunity to include the Kenai LNG plant in this process. Furthermore, there is the potential for lower cost in-state gas, although there wouldn't be the need for a long spur line.

REPRESENTATIVE DYSON inquired as to the advantages of the Valdez-only route.

MR. ALLEMAN explained that the Valdez route includes the existing Trans-Alaska Pipeline System (TAPS) corridor and thus there is possibly less resistance to environmental issues and possibly less landowner issues.

CHAIR OGAN pointed out that the next slide, "Stage 1 - Permitting Work" notes that any permitting time differences are doable within the current market timing needs. "If you already have permits for a route and you have fewer environmental hurdles ... how can a western route, the Cook Inlet route, be permitted in the same timeframe," he asked.

MR. ALLEMAN clarified, "We're saying doable within the current market timing needs." He pointed out that the base case refers to a 12-18 month difference. In the low case, there is the belief that with government-agency support it can be done in less time. He acknowledged that in a high case it may take more time; there is no exact science within the permitting world. He noted that both internal and external experts were brought in to perform an extensive analysis. He also noted that the Nikiski route doesn't pass through the Denali National Park.

MR. ALLEMAN continued with the presentation and explained that the design work and cost estimating exceeded expectations for what was intended to be accomplished in Stage 1. He pointed out that the accuracy level reached was +40/-20, which was taken even further in some areas and thus reached the pre-construction engineering design stage. He directed attention to a slide entitled "Stage 1 Work" that includes a photograph of the Stage 1 library that houses all the documented activities [of the Sponsor Group] as well as the 26 outside contractors. He summarized the fact that Stage 1 work was completed on time, within the budget, and exceeded engineering and design expectations.

CHAIR OGAN asked if that means that there will be a project soon.

MR. ALLEMAN answered that it means that the [Sponsor Group] is still trying to make this a commercially viable project.

REPRESENTATIVE DYSON mentioned the hub concept and asked if it appears viable to sell gas to the Midwest in the future. He questioned, "Is it possible to either do both or provide for both as we get started here?"

MR. ALLEMAN responded that [the Sponsor Group] believes there is enough gas to do both projects. He explained that part of the reason [the Sponsor Group] is moving forward is because it believes that although there isn't a commercially viable project yet, [the Sponsor Group] is confident enough that it maintains interest. One of the items that will be reviewed is in regard to how to share costs with a Lower 48 project. Furthermore, there is "that plum" in regard to obtaining the LNG markets at the turn of the decade.

REPRESENTATIVE DYSON inquired as to the conversion factor between gas measured in cubic feet at atmospheric pressure versus tons of LNG.

MR. ALLEMAN answered that, for rough figures, he takes the MTPA and multiplies that by .14, which results in the bcfd (billion cubic feet a day).

REPRESENTATIVE DYSON asked how many cubic feet of gas at atmospheric pressure would result from one ton of LNG. He requested that the presenters provide that information later.

MR. ALLEMAN returned to his presentation, which turned to Stage 2 and its key areas of focus. Stage 2 began last September and is a 12-15 month program that costs about $3 million. He noted that design cost optimization work is continuing and much work is being done with the synergy of shared cost with a Lower 48 pipeline project. There is interest in [including] a public entity or port authority concept to the project. Mr. Alleman highlighted the importance of identifying the key risks, their impact, and potential mitigation strategies. [The Sponsor Group] is also looking to alternate LNG markets, including the U.S. and west coast of Mexico. Furthermore, there has been and will continue to be much review of competing LNG projects. He noted that the permitting analysis is continuing and an

environmental assessment for the Cook Inlet route is being performed now in order to be able to move forward if the opportunity arises.

MR. ALLEMAN continued with the slide entitled, "Key Stage 2 Highlights." He noted that there has been additional capital expenditure optimization of approximately $400 million, which reduces the market entry project to 7.8 MTPA for $6.5 billion and that includes ships, or $4.9 billion excluding ships. Attempts to identify other cost savings opportunities that might be shared with the Lower 48 pipeline project are continuing. Mr. Alleman informed the committee that there has been evaluation of the public entity valuation in regard to how [the Sponsor Group] may be able to join with a public entity to form a project. Currently, there is no compelling evidence supporting a public-private project at this point. He explained that generally, the benefits passed to private enterprise would be taxable and the public borrowing rates are unlikely to offset private entity deduction of interest and depreciation.

REPRESENTATIVE FATE asked if that included the Port Authority, which claims to have certain tax advantages that might offset some of the costs.

MR. ALLEMAN answered, "Right now it would include, yes, any type of public entity and ... it doesn't mean there won't be something that we can find down the round that might match up, but the types of structures that we've seen so far wouldn't match up between the two - the public and the private."

GEORGE FINDLING, Manager, External Strategies, Sponsor Group, [Alaska North Slope LNG Project], interjected that this doesn't comment on the Port Authority or a government entity doing a project on its own. He explained, "This is primarily trying to put a project that's public and private together." The tax exemptions and relief enjoyed by the Port Authority would become taxable the moment it attempts to pass those on to a private entity.

MR. ALLEMAN continued with the presentation and turned to a slide entitled, "Stage 2 Market Engagement." He reiterated that until a fully defined, cost competitive project is developed and a need for new, green field projects is established, the market contacts are limited to updates on progress. Furthermore, there is continual review as to how [the Sponsor Group] compares with other markets, including nontraditional markets.

MR. ALLEMAN moved on to the "Economic Issues" to which the key is: "To become cost competitive with other East Asian LNG projects at a sufficient economic rate of return." From [the Sponsor Group's] standpoint, this project isn't quite there yet and isn't economic on a cost of capital basis in regard to the expected risk for a project of this size. He then highlighted the considerable additional efforts required as follows: reduce cost, share cost or find other synergy, reduce risk, and achieve meaningful fiscal modification. Mr. Alleman said, "For us, the truth here is: Project economic assumptions must be salable."

CHAIR OGAN referred to the slide entitled, "LNG Market View" that lists market competition. He inquired as to who owns the primary interest in each of the projects listed on the slide.

MR. ALLEMAN and MR. FINDLING said that information could be provided to the committee later.

CHAIR OGAN related his interest in seeing the relationship between what [the Sponsor Group] is justifying internally and the global forces that are competing within the same companies.

MR. ALLEMAN returned to the presentation and referred to the slide entitled, "ANS LNG Project Current CAPEX Estimate." The current estimated CAPEX is approximately $6.5 billion and that includes the following components: gas treatment, pipeline and compression, Nikiski LNG and terminal, and shipping. He reiterated that a primary effort in Stage 2 is to develop improved economics with shared cost of a Lower 48 pipeline. In closing, Mr. Alleman said, "This project is still alive and well. We've got a lot of work ongoing, attempting to develop this cost competitive project. And certainly we want to be prepared ... but we also want to be realistic about market timing and how we enter the marketplace."

CHAIR OGAN noted his confusion with the testimony that [the Sponsor Group] isn't competitive with other projects in the world, although it doesn't know what the other projects are or who owns them.

MR. ALLEMAN reminded the committee that his initial statement was in regard to [the Sponsor Group's] initial goal to obtain an economically viable project internally. However, now [the Sponsor Group] is looking outward. In fact, a workshop will be held in May, during which the issues regarding how [the Sponsor Group] stacks up to other projects [will be discussed].

CHAIR OGAN inquired as to the netback to the producers that would make the project economically viable.

MR. ALLEMAN said that he didn't have that specific number; it would be dependent upon the absolute price of the LNG that is sold.

MR. FINDLING explained that the focus on the Sponsor Group's commercial structure is to purchase gas at the wellhead and sell LNG. In further response to Chair Ogan, Mr. Findling said that [the Sponsor Group] anticipates that there will be a negotiation that would be complex, with many terms and conditions in regard to how the purchase would take place and how it relates to the market price, et cetera. Therefore, he felt that it would be difficult and inappropriate to establish a "rule-of-thumb" number for the minimum price or the netback.

CHAIR OGAN inquired as to whether there is a gas balancing agreement between the producers on the North Slope.

MR. FINDLING replied, no. In further response to Chair Ogan, Mr. Findling provided the committee with the following explanation of a gas balancing agreement. He explained that the idea behind a gas balancing agreement is to establish the process by which all the co-relative rights - the rights that each individual owner has in these jointly owned fields - have the rights to the gas and thus someone else won't take the rights to their gas. Therefore, everyone's rights would be protected in a unit setting.

CHAIR OGAN asked if the lack of a gas balancing agreement provided one company de facto veto power. That is, wouldn't the lack of a gas balancing agreement place [the Sponsor Group] at a disadvantage.

MR. FINDLING answered that that's not the way he saw it. The existence of a gas balancing agreement or lack thereof historically, hasn't been a process by which people have held up projects. He related his belief that as the economic interests converge and there is a desire to move forward, then these types of agreements are worked out.

REPRESENTATIVE JAMES asked if the gas balancing agreement is mainly intended to ensure fairness.

MR. FINDLING agreed that the gas balancing agreement is a way to establishing the rules under which gas can be taken.

CHAIR OGAN asked whether [the Sponsor Group] would meet the deadline of June 30th for application for projects wishing to take advantage of HB 393 from a couple of years ago.

MR. ALLEMAN answered that [the Sponsor Group] believes that it is qualified and prepared to do that. However, the date doesn't coincide with the time of need in the marketplace. There is a plan to [make a] decision on that in the upcoming quarter.

CHAIR OGAN inquired as to who would be [the Sponsor Group's] potential customers.

MR. ALLEMAN answered that the potential customers are all of the markets within Japan, Taiwan, and South Korea.

CHAIR OGAN asked whether Mr. Maroki(ph) is a major player in that.

MR. ALLEMAN replied yes. In further response, he felt that Mr. Maroki(ph) would have a buyer's perspective on market analysis.

REPRESENTATIVE FATE asked if there have been any studies regarding the possibility of moving laterally through Glennallen to Cook Inlet. He recognized that the throughput would have to be expanded.

MR. ALLEMAN answered that work has been done with taking in-state gas supplied from the Nikiski route and taking it to Anderson Bay. It has always been assumed that someone else would build the spur line to Anchorage and thus wouldn't be part of the project.

TAPE 01-17, SIDE B

CHAIR OGAN inquired as to whether there has been any review and comparison of the political and business conditions in Qatar, Yemen, Nantuna, and Sakhalin versus Alaska. He asked whether there is any advantage for markets to look to Alaska because of its political stability and military strength in the Pacific Rim.

MR. ALLEMAN related his belief that Alaska has political stability and a known, established gas supply that's already in existence, which are two distinct advantages. He mentioned, "And that's part of what we intend to do is not only just go back and look on straight up cost of service basis, but how else

do we compete with these projects; and how realistic are some of these other projects as far as really being able to come together at the end of the day also."

MR. FINDLING pointed out that the question may be: "To what extent will the markets value these ... advantages that Alaska has ...." He felt that [the Sponsor Group] believes that the market is, first, going to look for the lowest cost supply. Therefore, the other issues will be secondary.

CHAIR OGAN said,

> Because of that, we've got some internal conflicts with some of the producers' projects that compete. Those same people who are producers in Alaska have projects that are in direct competition with Alaska's projects. Comments that are made on the record by some of the producers that ... "Alaska just isn't competitive ... the projects ... that are good projects get funded by our company." I'm kind of fearful that ... because there's gas in other areas that are at tide water and we don't have to build a $7 billion pipeline, that our gas will be warehoused ... possibly an indefinite time. ... I've been here for a while and I remember all the discussion about ... you have to build this expensive pipeline and the capital investment, and I don't see much difference between that argument with LNG - why it might not be a competitive market - versus that argument on a pipeline route to the Lower 48 [where] you have to build a very expensive pipeline that's three times as long as our pipeline and then compete in a market where there's already lots of gas down there, it's just not in the pipes yet.

CHAIR OGAN remarked that if he were in the [Sponsor Group's] shoes he would be a bit discouraged by the governor's comments as well as some of the comments of the producers.

MR. ALLEMAN commented that since [the Sponsor Group] believes that there is enough gas for both projects, it behooves them to continue forward to develop LNG. From Phillips' standpoint, Mr. Alleman noted that he has a directive to continue to explore this option because it wants to develop every option available to it. The Lower 48 project is viewed as bringing a potential leveraging synergy to still do an LNG project, which is encouraging.

REPRESENTATIVE JAMES expressed her concern with some of the companies [in the Sponsor Group] also owning gas in other parts of the world. She recalled the testimony that the first consideration is the lowest cost. Therefore, she surmised that regardless of the owner, the price of getting the gas to market would be the determining factor.

MR. FINDLING replied, yes. If the costs are attractive to the marketplace, that's where the market will focus attention. Therefore, it isn't so much of a question of who owns it but rather the fundamental characteristics of the gas supply and the requirements to commercialize the gas and move it to the market. He related his belief that Alaska should focus on how it can be cost competitive with the other projects.

REPRESENTATIVE JAMES related her belief that the public is concerned that the perception of or real bias would lead companies to do things elsewhere because it is cheaper than Alaska. She inquired as to the answer to that.

MR. FINDLING emphasized that this is really about the fundamental cost structure of projects; it's not about gaming [in order] to obtain concessions. However, he noted that federal tax relief on an Alaskan project can make a big difference in regard to how competitive it looks in the marketplace. With such, the social question is whether that is in the best interest of the public to do such in order to help make a project competitive so that it will be competitive. Still, Mr. Findling maintained the importance of the fundamentals of these cost projects. Furthermore, the fact that the project is 800 miles from tide water is an issue that must be overcome.

REPRESENTATIVE JAMES asked if any consideration had been given to the possibility of the "public" building the pipeline and [the Sponsor Group] being charged to move the gas through it.

MR. FINDLING said that there have been some discussions with the Port Authority, which is the best model for such. There has also been review of the state's calculations regarding the benefits to an enterprise that was relieved from federal tax and that looks attractive. However, how such would be structured is a matter that needs to be discussed and worked out. He noted that [the Sponsor Group] will be discussing possible opportunities.

REPRESENTATIVE JAMES expressed concern with regard to the lack of Exxon's presence in this process. She asked if [the Sponsor Group] has had any conversations with Exxon.

MR. FINDLING informed the committee that when ARCO first lead the formation of the Sponsor Group, a variety of different companies were invited. However, at the time [ARCO] decided not to explicitly give the names of all the companies in order to [have candid discussions]. That tact has been maintained. He remarked that the Sponsor Group has quite a bit of gas represented by [Phillips and BP] and, in his mind, he included the state royalty gas as another possibility and thus there are enough reserves that the participation or nonparticipation of one company isn't really a leveraging thing.

CHAIR OGAN related his understanding that Phillips owns Timor Sea. He asked if there are any provisions in law that would penalize or jeopardize Phillips for delaying bringing natural gas to production in the Timor Sea.

MR. ALLEMAN said that he didn't know the specific answer. However, he expressed the need to avoid attempts to compare one element of the concession and fiscal system in one entity with the leasing and fiscal system in Alaska. There has to be a comparison of the entire [project]. He pointed out that Alaska has a strong leasing system and there is a fiscal structure that is at the pleasure of the state government.

CHAIR OGAN pointed out that part of comparing the project in its totality is comparing what Alaska's gas is competing against. Therefore, he said he would appreciate an answer to this question.

MR. FINDLING remarked, "I really have a hard time believing that some kind of punitive measure is going to help us become more cost competitive relative to other projects."

CHAIR OGAN said that if a board of directors has a fiduciary responsibility to its stockholders and gas that isn't developed in a certain area is lost or a tax is incurred because of the lack of development, that is a factor in regard to what is developed first.

CHAIR OGAN inquired as to the [Sponsor Group's] strategy for securing a gas supply and the assumptions for the wellhead price.

MR. ALLEMAN answered that the gas strategy is that there would be an open bid process and all the producers would be allowed to bid to supply gas to an ANS LNG project and the lowest bidder would be taken. He pointed out, "Obviously, if we're not competitive with what they can do other places, we won't see gas." He said that he didn't have any assumptions of what a wellhead price would be.

CHAIR OGAN inquired as to the price of gas on the East Coast.

MR. ALLEMAN replied that the delivery price to the East Coast would be the current U.S. Henry Hudd (ph) market price in those particular areas plus the differential. In further response to Chair Ogan, he recalled that the Everet, Massachusetts area is a long-term contract. However, he didn't know what the other markets - Cope Point, Elba Island, and a site in Louisiana - are looking at.

REPRESENTATIVE FATE asked if there is a grasp on the [projected] cost of capital or construction relative to things such as the wellhead price that are unknown. He said, "What I'm getting at is through these questions I haven't yet determined that the gas is not economical at this point because you have made some assumptions that when we've asked the questions, you can't answer them." If the anticipated wellhead price could be known, then it would provide [the state] the ability to anticipate what the market would be and thus whether this is economical at that point in the future. However, currently it seems difficult to determine whether this project is or is not economical.

MR. ALLEMAN said that the pieces provided today are the capital costs broken down. "We haven't tried to impute a cost of service to put in front you," he said. He pointed out that any forecasted long-term price would normally be confidential within our company. He explained that providing the committee with a cost of service number is problematic because to what is it compared. Certainly the raw numbers can be given to the committee, which was down with CAPEX numbers today. He noted that everyone will have different assumptions with regard to whether this is a profitable project.

REPRESENTATIVE FATE inquired as to when the committee will hear that this project is economic. These exercises could continue because everything is based on assumptions. He noted that the State of Alaska has to answer to its stockholders, the people of Alaska and thus he expressed the need to have [this information] so that [the state] can make some projections as well.

CHAIR OGAN announced that his patience with this is "running a little bit thin" because he has been involved with this for many years and it doesn't seem closer.

MR. FINDLING reiterated, "We are not cost competitive." However, he wasn't sure how that could be proven. He explained that he looked at the activities that people are doing to move ahead. The Sponsor Group has done a lot of work, spending $12 million, and developing an innovative design without suffering the cost disadvantages that one would expect on a per unit basis. Although [the Sponsor Group] is trying to move forward, the market is oversupplied and fiercely competitive. The market seems to indicate that this is a later-decade project.

CHAIR OGAN pointed out that there is a company interested in the project, if it could have the same open-bid process that the [Sponsor Group] has. He asked, "What's the deal?"

MR. FINDLING reiterated that [the Sponsor Group] has put a lot of work into this. He said that how to acquire gas is being thought of as a Sponsor Group versus a producer. Therefore, "nothing makes us particularly special in our ability to try to go and acquire gas ... other than we have a lot of work behind us," he said.

MR. ALLEMAN returned to the issue of the smaller entry project versus the larger project and pointed out that it's about the market risk. The [Sponsor Group] feels that its project is better than what was developed for the 14 million ton project. However, if 14 million tons can be placed in the marketplace, he said he would want expansion.

CHAIR OGAN turned to the U.S. West Coast market. He noted that BP recently announced building a receiving facility on the West Coast. However, he remarked that obtaining permits in California is difficult. He recalled that President Bush had mentioned easing the restrictions in regard to other countries selling the U.S. power. He inquired as to whether [the Sponsor Group] has looked at the West Coast market and what the delivery cost to the West Coast would be.

MR. ALLEMAN acknowledged that [the Sponsor Group] is now focusing on the West Coast market. It all turns on the sustained price over time, which is the same thing the Lower 48 pipeline would look at. He confirmed that there could be some synergies with the Lower 48 pipeline [because] the line is half

built and the gas is halfway there. He reminded the committee that there would still be a toll.

CHAIR OGAN inquired as to the impact to all these projects if the state announced that it would build a pipeline that would have enough capacity for both projects to Fairbanks.

MR. FINDLING agreed that is an interesting assumption. However, built into that are a couple of assumptions that the state would need to think about. The state needs to feel that it can execute the aforementioned project in a cost-competitive manner.

CHAIR OGAN remarked that even if the state was merely a co-owner in the pipeline, then there would be some advantages in that information that the state doesn't have now would be provided if the state is involved as a co-owner. He reminded everyone that the state owns 12.5 percent of the gas and perhaps the state should own 12.5 percent of these projects. He asked if the [Sponsor Group] would have any objections to the state reviewing that.

MR. FINDLING replied no.

REPRESENTATIVE KOHRING remarked that the pipeline should be built based on economics and whether the market justifies moving forward. Therefore, he had no problem waiting to see if this project eventually becomes feasible. He didn't believe that the legislature should rush ahead to get this pipeline built, although he would welcome the economic stimulus created. He noted his distaste to the idea of considering penalties to the industry but rather proposed review of an incentive package such as a tax reductions.

REPRESENTATIVE JAMES turned to the LNG market of the Lower 48. She related her understanding that there has been some reduction in the cost of producing LNG by a new method. Therefore, she asked whether the Kenai LNG plant would have to be retrofitted in order to take advantage of [the new method that reduces the cost].

MR. ALLEMAN assumed that Representative James was speaking of the Trinidad facility that is basically owned by BP. He explained that the cascade process was originally developed in Kenai. However, he acknowledged that there have been technological advancements since that facility was built. The project this group is reviewing is a stand-alone project that

would be in a different plant (indisc.) than the existing Kenai facility.

REPRESENTATIVE JAMES reiterated that the process is an advantage.

MR. FINDLING pointed out that there is a process called extended end flash (ph). He explained that as the LNG process is done and things are cooled, there's always gas that flashes off the end of the process. Normally, such is recycled back into the facility and reused to make LNG. However, with extended end flash that gas is taken and the pressure is released, more LNG is made than could be otherwise. Then [that gas that is taken during the extended end flash] can be sold to another facility, such as the existing Kenai facility, to put in its process. That is the advantage with using the existing Kenai facility.

REPRESENTATIVE JAMES explained that her question relates to the indication that other LNG facilities will be opened due to the decreased cost of LNG along with the higher cost of natural gas that has made LNG more competitive with natural gas. She inquired as to the ratio of the btus of using LNG versus natural gas without this decrease in the production cost. She also inquired as to what the cost would have to be in order to avoid LNG not being favored.

MR. FINDLING said that he didn't know now, but could provide that information later.

REPRESENTATIVE JAMES emphasized that if the state decided to be an owner in that, then the state would also have capital costs. She commented on the importance of trust in this issue.

CHAIR OGAN inquired as to what other projects the [Sponsor Group] anticipates would enter the marketplace before Alaska's projects. He also asked if the project was downsized because you think other projects will enter the marketplace before Alaska enters and thus the demand will decrease.

MR. FINDLING explained that there would be 20-40 million tons per annum of new demand in 2010. He agreed that Alaska would be competing with those other projects that don't have the 800-mile pipeline involved. However, he pointed out that [the Sponsor Group] is the only one that is discussing double digit [supplies] and thus it will take some time to develop.

MR. FINDLING, in further response to Chair Ogan, said that there are some projects that are closer to being developed than this project. He noted that analysis over the next couple of months will be done to understand that.

CHAIR OGAN inquired as to what projects [are closer to being developed] than Alaska's project.

MR. FINDLING said that there aren't any black-and-white answers. Each project faces its own set of issues.

CHAIR OGAN commented that it would behoove [the Sponsor Group] to know who "has the leg up" on them.

MR. ALLEMAN said, "We will."

CHAIR OGAN pointed out that the periodicals from the oil industry are full of information regarding the projects of various companies.

MR. ALLEMAN said that he could provide that information to the committee later.

CHAIR OGAN asked if there were any further questions. There were none.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 11:38 a.m.