

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 13, 2001

5:07 p.m.

MEMBERS PRESENT

Representative Hugh Fate, Vice Chair
Representative Fred Dyson
Representative Mike Chenault
Representative Vic Kohring
Representative Gretchen Guess
Representative Reggie Joule

MEMBERS ABSENT

Representative Scott Ogan, Chair

OTHER LEGISLATORS PRESENT

Representative Joe Green
Representative Lesil McGuire

COMMITTEE CALENDAR

KEN THOMPSON, PACIFIC RIM LEADERSHIP DEVELOPMENT: NATURAL GAS
TRADING HUBS

PREVIOUS ACTION

No previous action to record

WITNESS REGISTER

KEN THOMPSON, President
Pacific Rim Leadership Development
3601 C Street, Suite 1400
Anchorage, Alaska 99503

POSITION STATEMENT: Provided a presentation regarding natural
gas business and natural gas trading hubs.

ACTION NARRATIVE

TAPE 01-18, SIDE A
Number 0001

VICE CHAIR HUGH FATE called the House Special Committee on Oil and Gas meeting to order at 5:07 p.m. Committee members present were Representatives Dyson, Chenault, Fate, Kohring, Guess, and Joule. Chairman Ogan was absent due to illness. Other legislators present were Representatives Green and McGuire.

KEN THOMPSON, PACIFIC RIM LEADERSHIP DEVELOPMENT: NATURAL GAS TRADING HUBS

VICE CHAIR FATE introduced Ken Thompson who would provide the committee with a presentation regarding natural gas trading hubs.

Number 0110

KEN THOMPSON, President, Pacific Rim Leadership Development, informed the committee that over the last couple of years he was the Executive Vice President for ARCO's Asia Pacific operations as well as the head of Global Gas Marketing for ARCO. However, Mr. Thompson emphasized that today he is speaking to the committee as a concerned Alaskan who wants to speak out on his vision for North Slope gas. He specified that his comments today will be focused on the natural gas business in Alaska, gas trading hubs, and gas trading principles for Alaska that would create multiple market options for the future. He explained that Pacific Rim Leadership Development is a consulting firm in Alaska. Although this firm works with companies in the oil and gas industry, most of the companies the firm works with are not in the oil and gas industry.

MR. THOMPSON, in response to Representative Dyson, affirmed that he is no longer with [ARCO Phillips]. In further response to Representative Dyson, Mr. Thompson stated that his current clients are taught leadership development of executive teams. He identified some of his clients of which none were owners of gas.

Number 0325

MR. THOMPSON recalled when he was president of ARCO in 1995 when the Alaska Petroleum News reported that he was taking major steps to gather the owners for the first serious public effort in natural gas commercialization. That report said that "we" were taking strides to progress natural gas. However, Mr. Thompson said that he would amend that today to say that he is sprinting to [develop natural gas] and he thinks Alaskans should do the same. He emphasized, "I do think at \$3 per mcf (million

cubic feet) in the Lower 48, Alaska North Slope gas is commercial now and we need to make it happen." He related his belief that North Slope gas sales should begin by 2007. While working for ARCO, he started long-range plans with a start date of 2007. Furthermore, he thought that if gas sales weren't started by 2007, the state would lose patience by 2001 or 2002. Therefore, he felt that the state and the producers should try to work together to adhere to the 2007 timeframe. Such action will require taking steps now in creating multiple markets for the future in a broader natural gas business within Alaska.

Number 0511

MR. THOMPSON turned to slide 2 and pointed out that the "producers are completing studies to create their gas 'vision.'" Therefore, he suggested that the state should proactively complete separate studies to create a long-term "vision" that's best for Alaskans. Mr. Thompson, as an Alaskan, disagreed with the suggestion to wait and see what option the producers have because the producers' and the state's perspectives will differ. "The producers must focus on discounted present worth and rate of return of any project On the other hand, putting on the hat of an Alaskan, we need to make sure ... the option we propose should be one to create the most socio-economic benefit to Alaskans for the next 50 years because this is a long-lived resource base," he explained. Therefore, infrastructure in the state needs to be created as well as thousands more jobs. Perhaps a gas industry could be created rather than merely constructing a pipeline through which gas is shipped elsewhere. Such "vision" should be examined and a "win-win" situation found with the producers.

Number 643

MR. THOMPSON continued with slide 3, which delineates his recommendations for a business vision for natural gas. He recommended that the state support a gas pipeline that traverses Alaska. "If you consider the vision is to also create a natural gas business in Alaska, the Northern route is not even in my vocabulary. It is not an option; it has no value," he said. Furthermore, as a past oil and gas executive, he remarked that he wouldn't want the environmental or operational risk of the Northern route either. As former gas marketer, he also didn't like the Northern route because a better deal can be made if there are multiple markets and the Northern route only has one market. Such a situation should be avoided because markets could cycle in the next 10-15 years.

MR. THOMPSON remarked that if the desire is to have more gas distribution across the state at fair valuation and methodologies, then a natural gas hub should be created near Fairbanks or Delta Junction. He clarified that the hub isn't merely a series of valves and manifolds to distribute gas to different pipelines. Hubs common in the Lower 48, the United Kingdom, Canada, and the European Union, include trading principles and regulations for gas such that the netback price valuation is clear as well as the fact that the buyer can get access to the gas. Currently, Alaska doesn't have such rules or regulations in place and thus they are necessary before gas flows. Mr. Thompson offered the legislature his help in making sure that the [state] has these types of principles over the next couple of years.

MR. THOMPSON expressed the need for the state to retain 12.5 percent royalty share of gas in kind. [This is necessary because] initially the state could also market gas in the Lower 48. He remarked that the state shouldn't form a gas marketing company of its own, rather the state could contract with renowned firms such as Williams Energy Trading. The state's role should be to beat the price obtained by the producers because the state leases mandate that, for taxes and royalties, the state obtains the higher of actual proceeds or market valuation. If [the state] can beat [the producers'] prices, then the [state] can get higher valuation. Or, at least, the state should market the test that the producers are getting the best value for Alaskans. Another reason for the state to retain 12.5 percent royalty share is that such can facilitate the natural gas industry in Alaska. Mr. Thompson informed the committee that if a pipeline [produces] 2-4 bcf (billion cubic feet) per day, the state's royalty share would be about 250-400 mcf per day. He pointed out that the current gas usage in Alaska is 115 mcf (million cubic feet). Therefore, it is evident that the industry can be expanded if the 12.5 percent royalty share is maintained by the state.

Number 0990

MR. THOMPSON related his belief that the state's main role for business is to create a positive business climate. However, in this case, he recommended that the state invest 12.5 percent share in a gas pipeline, at least in the segment from the North Slope to the hub. He pointed out that the 20 years of disagreements on the Trans-Alaska Pipeline System (TAPS) have been in regard to tariffs and costs relating to tariffs. He

feels that the state should have a seat on the pipeline when decisions are made [so as] to know costs accurately. However, he emphasized that the state doesn't need to form a separate company or department to do this because there are [already] companies that can operate that interest for the state.

MR. THOMPSON turned to his recommendation for the state to formulate policies and regulations for clear and transparent valuation/pricing [of gas at the hub]. He informed the committee that in the prior two years he was appointed by U.S. Secretary of Energy Richardson to assist the Asia Pacific Economic Cooperative (APEC), which consists of 21 nations. He noted that he was one of the two Americans on APEC, both of whom were charged with helping business representatives from other nations develop natural gas and power generation policies in Asian countries. Mr. Thompson emphasized that currently it isn't clear how to netback price gas and that needs to be clear before the first gas flows. He noted that he has worked with other nations, such as China, Thailand, and Peru, on this type of netback pricing methodology, and therefore he offered his help to Alaska.

Number 1200

MR. THOMPSON, in response to Representative Dyson, said that he has spoken to Robert Gottstein who had inquired as to his views on the hub facilities.

REPRESENTATIVE DYSON noted that Mr. Gottstein seems to share Mr. Thompson's view in regard to the state having an ownership position [in the natural gas line] and employing a partner to manage it [that ownership]. Representative Dyson related his sense that those in Asia - Taiwan, South Korea, and Japan - are very interested in having a secure natural gas supply due to fears of their supply routes from the Middle East being interdicted. He inquired as to Mr. Thompson's thoughts.

MR. THOMPSON informed the committee that a U.S. Department of Energy security study shows that if the rate of increase in import by Japan, Korea, Taiwan, and China continues, they, particularly China, will be 90 percent dependent on Middle Eastern fuels. The "state department" is very concerned about that and thus teams have been sent to progress the natural gas industry in Asia to build those supplies. Mr. Thompson related his belief that LNG will be viable to some of these nations as long "we" can be competitively priced. Having personally marketed LNG to Japan, Korea, and Taiwan in the last two years

from the largest LNG plant in the world, he felt that it is difficult for Alaskan gas to compete with supplies from Indonesia and the Middle East. However, he pointed out that his proposal is to establish things so that the cycles change in which case the state would need to be prepared to ship LNG from Alaska in the future.

REPRESENTATIVE DYSON indicated that it would only take a radio broadcast of a change in the political situation in the Middle East to change that [cycle].

MR. THOMPSON agreed and emphasized the need for Alaska to be poised to have access to multiple markets such as the LNG markets in the future.

Number 1390

REPRESENTATIVE DYSON asked whether Mr. Thompson, as a consultant, would be available to help the legislature if the legislature decided to pursue his advice.

MR. THOMPSON replied yes and announced that he would waive his fees because helping the State of Alaska is important to him.

Number 1430

REPRESENTATIVE GREEN inquired as to how long Mr. Thompson predicted it would take for the state to gear up if it already had the hub.

MR. THOMPSON suspected that gearing up for LNG in the future would take 3-5 years or more. He noted that building the line all the way to the North Slope wouldn't be necessary because the line could be built from the hub to Valdez or Cook Inlet. He saw the only option that would provide a faster turnaround for LNG to be a trunk line from the hub to Anchorage and the Kenai Peninsula, with expansion of the Phillips LNG plant. He noted that he had no knowledge regarding whether Phillips was assessing such. In reviewing the various markets, Mr. Thompson stressed his belief that the Lower 48 market is the market that Alaska should proceed with and capture. Furthermore, the state should have the highest sense of urgency for the Lower 48 market while leaving itself open for some of the other markets.

REPRESENTATIVE GREEN remarked that if such occurred, he felt that a perpetual supply of gas would be available to "our area" and thus could create a significant industry in the Kenai area.

He interpreted Mr. Thompson's testimony to mean that if the facility is available, then ships and/or a cooler could be added in order to decrease the turnaround time considerably. He asked if Mr. Thompson saw any [merit] in a situation in which the state doesn't own the portion of the [pipeline] going to the operators or should the state be involved across the board, he asked.

MR. THOMPSON noted that he serves on the Natural Gas Policy Council and is on the committee dealing with in-state use. The committee plans to review different things for in-state use, including expansion of LNG or a future LNG project, as well as the size of the line from the North Slope to the hub and whether the line should be larger in order to handle capacity of future ideas. Perhaps the state, Native corporations, Alaska companies, or potential LNG participants and buyers would have to look at investing in such.

REPRESENTATIVE GREEN concurred with Mr. Thompson's testimony regarding the need for the state to "get with the program" quickly, if not immediately, in regard to having our own input because the oil industry's needs and views are different than those of the state. Therefore, he inquired as to whether Mr. Thompson felt that the state should seek a consultant with a worldwide perspective or could someone locally handle the job.

MR. THOMPSON answered that having a world-renowned consultant with a staff would [be ideal]. However, he reiterated his willingness to advise [the legislature] on issues involving methodologies and regulations for trading and price valuation.

REPRESENTATIVE GREEN related his belief that due to the Joint Committee [on Mergers] last year, the legislature is aware of the importance of having its own people to advise it.

Number 1827

REPRESENTATIVE DYSON [inquired] as to whether the hub in Delta would prohibit having a tap on the pipe in Fairbanks for local use.

MR. THOMPSON replied no and noted that he would discuss the two components of the hub later in his presentation. He remarked that the same trading hub methodologies and trading policies for natural gas, rights to access for gas, and the process by which the gas is valued in netback pricing for a potential buyer off the spur should all be very clear. This are standards.

Number 1879

MR. THOMPSON continued with slide 4 of his presentation. Slide 4, "Trading Hub and Natural Gas Business Vision with Future Multiple Markets Access," is a schematic that he suggested the committee envision occurring over 50 years. He posed a few scenarios for the committee to consider, such as a natural gas liquids processing plant for propane butane that can be trucked or barged into villages. Such a scenario would be cheaper and cleaner than the barged diesel being used today. He inquired as to why Alaskans can't dream and create this broader natural gas business vision while setting the policies before the first gas flows.

MR. THOMPSON turned to slide 5, which outlines how to put the gas business vision into motion. In 2001 there should be a resolution in support of principles of natural gas business in Alaska in conjunction with the Lower 48 gas line. In 2002-2003 there should be clear regulations regarding transparent netback pricing [in order to avoid litigation]. Such action would be a win-win situation for both the producers and the state. During 2002-2003 there should be clear rules for transparent access for in-state use. For example, if a producer sells in Chicago for \$3.00 mcf and the netback price at the trading hub is \$1.00, what should the cost be to Alaskans that want to access gas. Mr. Thompson felt that cost should be \$1.00 or slightly above. "If they can meet or beat the netback pricing, that should be the deal," he charged. However, under the current regulations a producer could say that if their natural gas isn't used, then diesel would have to be used. One alternative for the use of diesel is barging it up from Seattle; the market is that replacement cost. Therefore, the state needs to establish regulations for access and the price of access based on netback pricing. Furthermore, there should be rules for clear access for overseas markets. Also, the state should finalize its decision of investment during 2002-2003. During 2004-2006, he envisions the state attracting investors for the hub and spur lines for in-state distribution, city infrastructure, and value-added processing. Although this may be "small potatoes" to the producers, it could be very attractive to small Alaska companies or Native companies. The year 2007 is when he envisioned Alaska having "Gas to Cash" for Alaska and Alaskans.

MR. THOMPSON remarked that the remaining slides are further justifications that have already been discussed.

Number 2268

REPRESENTATIVE DYSON noted that some don't favor the trans-continental pipeline and thus say that the \$3.00 per mcf will empower more exploration and deeper wells in the Gulf and off the east coast of Canada. Thus, the market would respond to the price and supply the need further than we see.

MR. THOMPSON pointed out that what Representative Dyson described can happen in any market. If the current eight or nine projects that could be viable in Asia were done at the same time, then it could happen. In fact, Japan's utilities have a very organized effort under way to convince everyone that their project is the winner so that everyone will build the project so as to have an oversupply of LNG, and then have LNG prices decrease. Although there is gas in the Rockies that could be developed, it is reserves without the rate capacity. He explained his belief that the gas from the Rockies would add reserves, but not enough incremental rate. Furthermore, the Gulf of Mexico is "falling off" more rapidly on shelf gas deposits than some forecasted.

MR. THOMPSON noted that the Camber Energy Research Associates (CERA) met with us on the Natural Gas Policy Council. He pointed out that the Lower 48 market is about 60 bcf of gas per day and Alaska production would perhaps increase from 2 to 4 [bcf]. However, what's remarkable with the U.S. market is that if the demand is growing at 1.5-2 bcf a day per year, within a year a lot of gas could be absorbed from Alaska, Canada, and off-shore. In fact, most believe that would happen and thus would bring prices from \$5 plus per mcf down to the \$3 mcf described earlier. However, Mr. Thompson felt that Alaska could compete better than other sources where the rate capacity is not as high as Prudhoe Bay, which can already produce 8 bcf a day. As long as Alaska gets in the market now in the Lower 48, Alaska will win in [the Lower 48] market.

Number 2465

VICE CHAIR FATE asked if Mr. Thompson had a scenario of development. He asked if Mr. Thompson's aforementioned target year of 2007 was for flow, for the beginning of the pipeline, or for establishing markets.

MR. THOMPSON clarified that he meant 2007 would be the beginning of gas sales [flow of gas]. Therefore, the producers would have to make decisions regarding moving forward for permitting and

making the project happen by the end of this year or early 2002. He understood that some on the Gas Study Group also use a 2007 target year while others target the year 2008. Either 2007 or 2008 seem feasible if a decision is made by July 2002.

Number 2549

MR. THOMPSON returned to the presentation and continued with slide 8, "Natural Gas Trading Hub/Contracts." He highlighted the fact that although the hub concept is a physical system, it is a contractual system as well. Furthermore, although spur lines are an alternative to hubs, he charged that Alaska should ensure that there is no alternative to the contractual [hub] system. Even if the physical hub isn't done, he felt that there will be investors who will want to review a trading hub. Although trading hubs may be new to Alaskans, they are fundamental to gas distribution and for clear transparent trading. The Lower 48 has numerous trading hubs as does Canada, the United Kingdom, Europe, and they are progressing in Asia. For example, the old ARCO was working to progress a natural gas trading hub in the gulf of Thailand that could ship and transport gas to Vietnam, Malaysia, and Thailand. He pointed out that it was a contractual system with these countries.

Number 2627

REPRESENTATIVE GREEN pointed out that customarily gas contracts for the Lower 48 are long-term contracts that can be in the range of 20 years. He asked whether Mr. Thompson's proposal would continue under that long-term timeframe or should there be a new perspective.

MR. THOMPSON explained that in the Lower 48, the trading mechanisms and the instruments to hedge the prices are so sophisticated that most financing for most projects won't use long-term contracts. He imagined that in the Lower 48 market one-fourth of the sales may be long-term contracts, one-fourth of the fuel and contracts may be medium-term contracts, and perhaps 50 percent of the volume may be sold on the spot market. Also, [the state] should watch for more integration of gas supply tied to power plants in the U.S. Mr. Thompson indicated that Alaska should consider adopting [at least] elements of the European Gas Directive regulations, which require a party to disclose if it is a party downstream. Such relates to the trading hub methodologies and pricing valuation regulations, which don't exist in Alaska.

Number 2799

MR. THOMPSON returned to his presentation and addressed slide 9. He informed the committee that arrangements in the U.S. [Lower 48], the European Union Gas Directive, and the United Kingdom's Natural Gas Trading are examples of regulations [that Alaska should consider]. He pointed out that the same producers in Alaska are the same that contributed to developing the regulations in the aforementioned countries. He then turned to the rights for access. If a person with a proven financial capability bids a competitive price and the capacity is present, that person should have the right to the gas. That is the case in the aforementioned countries.

VICE CHAIR FATE asked if the existing contracts for gas would allow such.

MR. THOMPSON replied no. He explained that such would have to be [addressed] in the trading agreements and the regulations within Alaska. There are no lease requirements that specify that the producers have to sell to anyone that can meet the netback price. However, as he suggested earlier, the producers will probably have some percentage of long-term and medium-term contracts for financing; that is a contract that Alaskans wouldn't have the right to get that gas. He clarified that he is referencing the excess capacity. This is another [reason] why Alaska should maintain its royalty share because Alaska can manage that.

TAPE 01-18, SIDE B

MR. THOMPSON expressed the need for access rules to be clear. he noted that he had already covered slide 10 as well as slide 11. He emphasized that if the state doesn't invest in the natural gas pipeline, then allow Alaskan companies to invest in the 12.5 percent share and thus more profits would be kept in the state. Therefore, there would be some people "at the table" whose board of directors are in Alaska.

Number 2891

REPRESENTATIVE GREEN posed a situation in which [the state] has the 12.5 percent and a proportion of long-term contracts, while the operators have some short-term to medium-term contracts. The line is in and going, but the entity is going to cut back production and hold. At that time, [the state] was doing its 12.5 percent. He said, "Now they cut back. Does that

adversely, in your opinion, effect our rate at 12.5 before they cut back?"

MR. THOMPSON noted that he wasn't sure of the structure on the gas pipeline. Perhaps it will be constructed so that each owner will have contractual volume shares in the lines. For example, if the line is capable of moving 2 bcf a day, the state, if it chose to invest, would have a contractual right to move 12.5 percent of 2 bcf at any time regardless of what the others were moving. He agreed with Representative Green that this would go back to the productability. Therefore, if the producers, because of poor market conditions, opted to cut back, they can do so. However, where there are contracts, the producers would have to provide those volumes. Mr. Thompson pointed out that the state may choose to keep supplying in-state businesses for other business reasons. Perhaps the state would make more money from the taxation of those businesses than the royalties.

REPRESENTATIVE GREEN surmised then that [the producers] could require more than 12.5 percent of the production.

MR. THOMPSON said, "Of the net capacity?" He identified that the issue Representative Green is raising as one that hasn't been resolved in the gas pipeline. He related his understanding that if some cut back [contractual volumes], then others can produce their full volume. However, he said that he didn't know how it would evolve.

MR. THOMPSON returned to his presentation and noted that slide 12 had already been discussed. However, he acknowledged that it may be difficult to perform the actual negotiations as was the case with some of the oil agreements. Still, Mr. Thompson hoped that there could be a win-win situation in which the producers and the state could do it up front in order to avoid lawsuits after gas is flowing.

Number 2720

MR. THOMPSON moved on to slide 13, "Example Resolution Principles for Alaska - European Union Gas Directive." The European Union Gas Directive [principles that Alaska should review] includes the following:

Gas transmission, distribution interconnected, no barriers;
State(s) regulates gas business: nondiscriminatory, clear;

Fair and open access to the natural gas system;
Access to pipelines allowed under set of transparent
rules;
Participants in the market will not abuse their
dominant position nor engage in predatory behavior;
Participants have open, nondiscriminatory storage
access;
Gas suppliers will compete freely for "eligible
customers."

MR. THOMPSON closed with slide 14, which offers key conclusions of a gas business vision, and slide 15, which delineates the steps to reach the gas business vision. He offered to answer any questions.

Number 2620

VICE CHAIR FATE thanked Mr. Thompson. He then related his belief that legislation is necessary and thus the committee would be happy to have Mr. Thompson's help in that vein.

MR. THOMPSON remarked that he would be honored to help clarify a resolution of principles that are favorable for the Lower 48 gas line while establishing the principles for a financial gas industry in Alaska.

REPRESENTATIVE GREEN mentioned that Mr. Thompson was the author of ARCO's "No decline after '99." Although many thought Mr. Thompson was crazy, there was no decline but rather an increase [in production] after 1999. Representative Green explained that he was using that to illustrate that Mr. Thompson is a man of vision and honor.

Number 2531

MR. THOMPSON, in response to Representative Dyson, said that the resolutions in the system should be reviewed to determine whether the current resolutions should be amended or whether a new resolution should be drafted. He offered to provide advice in that area.

REPRESENTATIVE DYSON expressed the need to meet with Mr. Thompson in order to outline this and its scope.

MR. THOMPSON agreed and remarked that such could be accomplished in a principles type of format from which the details could follow in the future.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 6:07 p.m.