JOINT HOUSE & SENATE FINANCE COMMITTEE
September 11, 2003
9:00 A.M.

TAPE HFC 03 – 110, Side A
TAPE HFC 03 – 110, Side B
TAPE HFC 03 – 111, Side A

CALL TO ORDER

Senator Lyda Green called the Joint House & Senate Finance Committee meeting to order at 9:00 A.M.

MEMBERS PRESENT

Co-Chair Lyda Green
Senator Donny Olson

Representative Chenault
Representative Croft
Representative Hawker
Representative Stoltze

MEMBERS PRESENT VIA TELECONFERENCE

Co-Chair Bill Williams
Representative Whitaker

MEMBERS ABSENT

Co-Chair John Harris
Representative Kevin Meyer
Representative Foster
Representative Joule
Representative Moses

Co-Chair Gary Wilken
Senator Con Bunde
Senator Lyman Hoffman
Senator Ben Stevens
Senator Robin Taylor

ALSO PRESENT

Senator Gene Therriault, Speaker; Representative John Coghill; Representative Hugh Fate; Representative Bob Lynn; David Freer, Sempra Energy, Vice President for Federal Affairs, Washington D.C.; Harold C. Heinze, Chief Executive Officer, Alaska Natural Gas Development Authority (ANGDA); Greg Bartholomew, Director, Strategic Planning and Analysis, Sempra Energy International; Steve Porter, Deputy

Commissioner and Liaison to Alaska Natural Gas Development Authority, Department of Revenue
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SUMMARY

State Priorities for Alaska's Stranded Gas
Alaska Natural Gas Development Authority Funding request
Alaska Natural Gas Development Authority's appropriate role

SENATOR LYDA GREEN noted for the record that there were not enough members present to form a quorum. The working group could pass messages forward, however, no meaningful decisions could be made. She noted that Nome, Fairbanks and Juneau were being teleconferenced.

DAVID FREER, SEMPRA ENERGY, VICE PRESIDENT FOR FEDERAL AFFAIRS, WASHINGTON D.C., commented that in the 1970's, Southern California Gas Company preceded with an effort to place a liquefied natural gas (LNG) receiving terminal near Santa Barbara, California. The project was the result of efforts in Alaska to bring out LNG gas. The project at Port Conception died as has other projects designed to bring gas out of Alaska.

At present time, a similar situation exists, with one distinct difference: a fully permitted receiving terminal is awaiting construction on the West Coast. Construction would begin in 2004.

Mr. Freer discussed Sempra Energy Utilities. He noted that the company's 2002 revenues were in excess of $6 billion, with four thousand employees. The headquarters is located in San Diego, California. Sempra Energy (Sempra) is the parent company of two distinct entities:

- Sempra Energy Utilities, the regulated side of the company, comprised of the Southern California Gas Company, which is the largest natural gas local distribution company in the United States and San Diego Gas and Electric, serving the San Diego area.

- Additionally, Sempra Energy Global Enterprise, the umbrella company for Sempra Energy growth businesses, including Sempra Trading, Sempra International, Sempra Energy Resources, Sempra Energy Solutions, and Sempra Energy LNG Corporation.

Mr. Freer pointed out that currently, there is a facility, which is well into the process of having necessary receipts from the Mexican government in order to proceed with construction. Sempra Energy is the lead company in the process. The next step is to find a supplier, enter into an agreement so that necessary construction can target a 2007 date.

Mr. Freer highlighted points to that timetable. He emphasized that Sempra Enterprise wants to work on an agreement with Alaska to be the supplier at Costa Azul, the energy-receiving terminal. Sempra Enterprise previously, had communicated that intent to Harold Heinze, Chief Executive Officer, Alaska Natural Gas Development Authority (ANGDA), at a meeting in San Diego, August 2003. Mr. Freer stated that it makes "economical sense" for the State to engage in that, acknowledging that there could be constraints in an arrangement between Alaska and Sempra Enterprise.

- Sempra Enterprise is in serious negotiations with a number of foreign governments and international oil and gas companies for supply capacity for the cost of the terminal. The negotiations have been underway for sometime and are being conducted between Sempra senior management and the heads of state and senior officials of international oil and gas companies. Negotiations are being conducted at their requests in order to enter into an agreement. He noted that all these governments and companies are located in the Pacific Rim, making them direct competitors to Alaska.
- Sempra Enterprise intends to conclude the negotiations in a timely fashion and fully expects to have a contract within 30-60 days.
- When an agreement is reached between the supplier and Sempra, the other competing terminals will essentially fade from the scene. When an agreement is signed, it is unlikely that there could be capacity elsewhere on the West Coast at another terminal. He stressed that there is only "so much of a market" that LNG can absorb.
- When that occurs, the market would essentially close to the West Coast for an additional LNG supply from any other source. Future expansion would be incremental.
- Present time is a "critical juncture" with respect to an agreement for LNG from Alaska to Costa Azul. The timetable is locked-in and the schedule to proceed is well established. At this time, ranked in order of priority and in terms of opportunity, Alaska could be last. If there is to be an

opportunity between Alaska and Sempra, there must be a strong indication from the State that there is interest in crafting an agreement, which entails the following:

(1) An immediate signal that Alaska will initiate negotiations with Sempra Enterprise; and
(2) That the negotiations would proceed in a manner consistent with the previously identified time frame; and
(3) That the political leadership of the State is behind the effort and will see that it proceeds expeditiously.

Mr. Freer reiterated that Sempra Enterprise is interested in working with Alaska. While it is unfortunate that the respective timetables are not parallel, Sempra Enterprise would be interested in "sitting down" with appropriate parties to fashion a mutual supported agreement.

Senator Lyda Green asked who the members of Alaska Natural Gas Development Authority are.

HAROLD C. HEINZE, CHIEF EXECUTIVE OFFICER, ALASKA NATURAL GAS DEVELOPMENT AUTHORITY (ANGDA), noted that he had placed key exhibits around the meeting room, one of which indicates benefits to Alaskans and also, maps of the various pipeline routes from North to South. (Copy on File).

Mr. Heinze stated that the Authority was a creation of Ballot Measure #3, which was passed in the November 2002 election. (Copy on File). That measure received wide support. He noted that the Authority is benefit driven so that they can accomplish tasks rather than being a study group.

Mr. Heinze pointed out that the Authority is a "young organization", provided with a minimum budget, allowing them to come into being. The budget does not permit very much "action" and acknowledged that he was before the Joint Finance Committees, looking for money.

Mr. Heinze noted that ANGDA is a public corporation run by its' Board similar to the Alaska Railroad. There is a seven-member board of directors consisting of Andy Warwick, Chairman, Fairbanks; Bob Favretto, Kenai; Dave Cutty; Scott Hayworth; Dan Sullivan, Anchorage; Warren Christian, and John Kelsey, Valdez. The Board runs the corporation and can issue revenue bonds. The Authority is an agency of the State and hence does not need to acquire a right-away but can administer State lands. ANGDA does have the authority of eminent domain. The intention is to build and operate facilities in Alaska and to commercially buy and sell gas as well as transport it.

Mr. Heinze added that ANGDA offers an alternative to the State to invest and capture the rewards and that the agency is benefit driven. The chart indicates many important issues regarding how it will affect the economy and jobs and how gas will affect heating and power. Coming out of Prudoe Bay, there could be many lines spurring off and providing gas to all population segments. That in addition to dollar motivation is important to the Authority.

Mr. Heinze added that there is a West Coast market opportunity now and the shorter shipping distance favors Alaska LNG. At this time, there is no LNG delivered into the West Coast; however, within a matter of a few years, LNG will be delivered there. It is reasonably expected that only one or two terminals will be built on the West Coast and that Alaska is competing for that market. He emphasized that Alaska should attempt to secure that market.

Mr. Heinze emphasized that the proposed numbers do not have detailed information behind them, however, they are reasonable for what an Alaskan LNG project could look like. He referenced the chart on Page 3 of the handout. (Copy on File). The chart indicates a total expense of $12 billion dollars. To calculate a notional cost of service from that amount, illustrates how the Authority differs from the economics of the project. The cost of service indicates a number of the whole transport cost of the gas. To add to that wellhead purchase price, the number summed together is what is compared against what the market will pay. With a $12 billion dollar investment, wanting a high rate of return, the party would need $2.90 dollars to transport that gas. The Natural Gas Development Authority does not pay income tax; consequently, an investment at $2.20 dollars would be a "good investment". The simple elimination of taxation lowers that number from $2.90 dollars to $2.20 dollars.

Representative Croft asked if it was anticipated that 16 million tons per year input would be received on the West Coast. Mr. Heinze explained that at two billion cubic feet per day, 16 million tons per year would be the amount that could fill the West Coast marketplace. He admitted that might not be initially achievable. He informed members that Sempra Enterprise understands more about the market than ANDGA does. A large amount of that could easily be placed on the West Coast. The number is critical at 16 million tons per year because it is possible to place one and two million tons at a time to at least three or four other markets. He reiterated that was a "believable" amount.

Representative Croft commented that $2.20 dollars would be a "good rate of return" since the State is non-taxable. He inquired the projected price of the natural gas. Mr. Heinze understood that current prices on the West Coast were between $4.50 & $5.00. There are projections that this price will hold. The low range of price structure would be between the $3.00 & $3.50 dollar range. If the State drops from being a profit making organization, then economic activity would still be generated and the State would be servicing debt. As an infrastructure investment, the number could drop to $1.65, a number that contains no profit but adequate service for debt, the investment is returned and ownership would result at the end.

Mr. Heinze acknowledged that the numbers appear "strong". At $2.90 dollars, that kind of number, the producer might calculate which is marginal. At $2.20 dollars, it would be competitive with any other LNG project. That is a strong number and he reiterated that no tax would be paid.

Mr. Heinze spoke to the risk element. The Authority is immune from fiscal changes. There are ways to manage the risk and minimize it. The beauty is that the State could receive the awards. If the price held at a high level, the State could pay the project off in three years. He outlined why ANGDA is getting into the gas business:

- The Authority will work out commercial terms with a producer–led highway pipeline for gas delivery to maximize Alaska's benefit;
- LNG based all-Alaskan project is economic and competitive for non-taxable Authority;
- Alaska's portfolio of other gas or LNG projects is limited; and
- Alaska doesn't have multiple shots at a dynamic Pacific Rim market.

Mr. Heinze commented on the anticipated strategy:

- Support producer-led highway gas line and define compatible Alaska benefit projects;
- Keeping the wellhead price of gas high to encourage development of new reserves and higher current revenues; and
- Using margin to support public purposes.

The ANGDA Board requests accelerated funding of up to $3 million dollars to finish the conceptual design, make a good cost estimate, and proceed with the marketing effort by January 2004. Ballot Measure #3, by law, requires that by June 2004, Alaska provide all itemized indicators with the intention that a decision can be made as to whether to proceed or not for major investments. He reiterated that ANGDA recommends that time frame be brought forward. The request, by law needs to be completed and the decision needs to be made as to when it is to be finished and available.

To accelerate the funding request, specific issues will be addressed. The producers have spent $125 million dollars within the last few years to finish the design work of the highway project. For Alaska to successfully interact with them and provide the benefits, the technical gap needs to be closed and Alaska needs to define the project in order to have meaningful discussions.

Co-Chair Williams asked how the present discussion would affect current negotiations in Washington D.C. on energy legislation. Mr. Heinze responded that Steve Porter, a scheduled speaker later at the meeting, would be able to address stranded gas and concerns occurring in Washington D.C. He advised that ANGDA's work is "neutral" regarding what is happening in Washington D.C. because ANGDA is attempting to work compatibly with the highway project.

Co-Chair Williams voiced concern that "Washington D.C. is watching" and that perhaps the State should not do anything until those negotiations are completed. He warned against "making waves" for the Alaska Congressional delegation.

Mr. Heinze commented that the requested spending would be focused on new concepts for Alaskan benefits. The pay-off would be for Alaska, and not any specific company. Alaska is currently at a point where there is significant free work being contributed. Also, the requested money would be focused in Alaska on contractors and design work by: ASRC Energy Services; VECO; Peratrovich, Nottingham & Drage; Wood Mackenzie; and Northern Economics. Because of the effort of these companies, ANGDA has been able to provide the proposed estimate. The intention is that with the requested money, ANGDA would be able to convert the work and estimates into contracts for sole-source basis.

Mr. Heinze pointed out new design elements:

- A spur line from Glennallen to Cook Inlet area;
- A barge mounted LNG plant & LNG storage tanks;
- LNG plant & loading berth at the old Valdez town site; and
- LNG thermos barges.

Mr. Heinze pointed out that Page 8 indicates the actual study.

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Mr. Heinze detailed the costs of the elements of the study contained on Page 8 as follows.

Design & Execution Plan	
Pipelines	$500 k
LNG	900 k
Marine	400 k
In-State Uses & Benefit Analysis	150 k
Marketing/Competitor Analysis	200 k
Specialized Legal Opinions	150 k
Staff & Administrative	200 k
Total	$2,500 k

Mr. Heinze informed that the pipelines, LNG, and Marine designs would be "new concepts and high benefit type designs" that have not been considered previously and that would add value. He stated very little if any of these funds would be expended for existing estimates or designs.

Mr. Heinze spoke to the benefit analysis saying that all the uses could be quantified, although have not been quantified before.

Mr. Heinze emphasized that to be successful, "marketing is one of the keys". He stated the funds would be utilized to engage "one of the premier type of consultants in the world in terms of LNG and where our competition is and how we stack up against that competition."

Mr. Heinze qualified that a number of legal issues must be clarified relating to taxation, bonding and to the Jones Act and its applicability to our project. He noted these are specialized areas and expected any "prudent investor" to have "substantial legal opinions" on at least these three areas.

Mr. Heinze next listed information to be included in the study, shown on Page 8, as follows.

- Contributed Studies (Donated Information)
    - Yukon Pacific
    - Alaska Gasline Port Authority
    - Tanker Design and Cost
    - Training in Alaska and Alaska Hire
    - Gas Compositions and Conservation
- State In-House Expert Consulting
    - Revenue Projection and Tariff Modeling
    - Social and Environmental Responsibility
    - Permitting and Land Use / Planning

Mr. Heinze noted this information has been obtained at no cost. He said this information is “available for us to build on and look at, and use to the extent that we can in terms of our design.” He anticipated that businesses involved in tankers would assist in the design of the ships and that the “labor components” in Alaska would benefit from defining issues relating to Alaska hire.

Mr. Heinze indicated five issues are identified as “Benefits in Design Concept” on page 9, as follows.

- Spur line to <u>Cook Inlet</u> provides future residential and industrial gas supply in area
- Study of barge mounted LNG plant would allow multi-$B fabrication in <u>Cook Inlet</u>
- LNG thermos bottle barges can supply <u>coastal communities</u>
- Expanded <u>Kenai</u> LNG and urea plant options
- Propane content in gas line key to <u>Yukon River</u> supply and petrochemical plants

Mr. Heinze posed the question; titled “Why Proceed Now to finish Project Concept Design” answered on pages 10 and 11, which reads as follows.

- Market Pull – a complete conceptual design essential to being considered a “real” project by LNG buyers
- Producer Decisions – discussion with producers needs to be based on the value ANGDA adds to their product by satisfying a completely defined set of Alaska’s needs
- Project Management – timely disclosure on critical design elements will allow focus on business decisions
- Energy in Alaska – Major energy decisions and commitments are being made without this project’s options and alternatives included in the framework

Mr. Heinze stressed that whether by Sempra Energy or another producer, the market is “being defined” on the West coast of the United States. He expressed he has made effort to represent Alaska in “moving that forward”; however, he was “operating from an incomplete package”. He instructed that “in marketing” “you have to have a total story to tell, and I’ve got a 90 percent story right now. I need to finish that to make this happen.”

Mr. Heinze cautioned that producers could already be making decisions related to the design of the pipeline that could affect how they interface with Sempra Energy. He explained that when industry is ready to proceed, the State must have a clear understanding of its goals. He informed that this is an opportunity to “put our schedule here in a pretty good order” by proceeding ahead, clarifying engineering aspects and allowing sufficient time of several months to concentrate on the business and financial aspects.

Mr. Heinze remarked that “every day here in Alaska” significant long-term decisions are made without consideration of the proposed project. He was unsure how this project would influence those decisions; however, he stressed its importance.

Mr. Heinze related the ideal occurrences related to this project would be favorable response from the federal government followed by agreements between the producers and the State of Alaska Administration to be presented to the legislature for approval. He stressed that “tens of billions of dollars” are “at stake” for the State. He recommended that the legislature should determine what information it needs to made decisions on the matter during the upcoming legislative session.

AT EASE [Note: audio continues during break.]

GREG BARTHOLOMEW, DIRECTOR, STRATEGIC PLANNING AND ANALYSIS, SEMPRA ENERGY INTERNATIONAL, testified to his 12 years with this company and eight years at Exxon. He utilized a slide presentation and the copy was not provided.

Mr. Bartholomew indicated a slide illustrating production and demand in the Lower 48 and comparing historic consumption. He stated that in the early 1970s the United States had price regulation of natural gas and as a consequence, a natural gas shortage occurred with a decline of consumption and production. This, he said resulted in construction of nuclear power plants. He continued that in the middle 1980s price deregulation allowed additional development of natural gas and subsequent increased production. He noted that consumption increased at a greater rate than production and as a result, natural gas was imported from Canada, primarily from Alberta. He informed that the imports have steadily increased to a point that Canadian imports represent approximately 16 percent of U.S. gas consumption.

Mr. Bartholomew relayed Sempra Energy’s position that the U.S. has “reached a peak” in gas production and is beginning to decline. However, he remarked that consumption is increasing because natural gas is clean and efficient. He shared expert’s predictions that gas consumption would continue to increase as long as the U.S. economy continues to grow. He cautioned of the ramifications of a potential gas shortage.

Mr. Bartholomew compared this situation to that of oil production. He reported that oil production in the Lower 48 peaked in 1970 and has since declined by over 50 percent. He stated that “a number of frontier developments have occurred,” including shallow water activities in the Gulf of Mexico and Alaska, and deepwater activities in the Gulf of Mexico. He asserted that this has slowed the decline but has not halted the decline, although consumption has continued to increase to 60 percent of production. He predicted that by the year 2010, the ratio could be as high as 70 percent.

Mr. Bartholomew next spoke to events affecting price, noting that through the 1990s the equilibrium price of natural gas has been steadily increasing at a rate of approximately five percent annually. He stated that “price shocks” occurred in the years 2000 and 2002. He relayed that Sempra Energy considers these price shocks as signals as to “limits with regard to our natural gas resource”. He referenced the New York Mercantile Exchange (NYMEX) prices for future natural gas, showing that prices were “fairly low” in January 2002; however, currently the price expectations for six years from now “are quite high, in the $4.50 to $5 range.” He expected that LNG would “be setting” the price for natural gas in the Lower 48 in the indefinite future.

Mr. Bartholomew spoke to the natural gas consumption of western states, including Nevada and Arizona of the past 13 years. According to the California Energy Commission, he said, natural gas consumption would continue to grow at a rate of approximately one percent in California, which represents two-thirds of western states’ consumption. He qualified this is not a significant rate and therefore raises the question of why there is a need for LNG.

Mr. Bartholomew explained the demand for LNG and the reason for the number of terminals proposed for location along the west coast of the U.S. is because western state gas production is declining “very rapidly.” He indicated a slide plotting the production of natural gas in California, including off shore locations. He stated that a “spike” in production is the result of a purchase of a field in Bakersfield California and the harvesting of that resource. However, he remarked that the resource at the location is finite; production is declining at a rate of ten percent, and would no longer provide the current 40 percent of production in that state. He concluded that California production is declining and that “no amount of drilling”, of which very little is occurring, could reverse the trend.

Mr. Bartholomew continued in detailing the decline of the coal bed methane in the New Mexico/San Juan Basin at an approximate ten percent rate. He stated that despite high prices and high “rig counts”, the decline has not stopped or reversed.

Mr. Bartholomew noted that basins in Alberta, British Columbia and Saskatchewan are among the most reliable sources. He asserted, however, that production from this area has plateaued and would begin to decline. He mentioned a forecast that is consistent with the Canadian Potential Gas Committee’s estimates for undiscovered resources, which illustrates that substantial future declines would occur.

Mr. Bartholomew also spoke to another Permian Basin that has experienced no changes in production levels, and areas in the Rocky Mountains with declining resources. He remarked that the quality of resources in Colorado and Wyoming is declining. He alluded to a slide showing the historic gas production in Utah with a forecast, and natural gas sales in Wyoming. He noted that Wyoming has been referred to as “the Persian Gulf of natural gas”; he pointed out that much of the gas is contained in rock “as tight as concrete” and it was unknown whether technology would advance to allow the gas to be recovered. He also informed that with the exception of gas production from the Jonah field and Powder River coal bed methane, gas production in Wyoming has been “flat” for the past six or seven years. He therefore disputed the assertion that Wyoming would “save North America”.

Mr. Bartholomew assured that although the gas supply in North America is limited, significant gas exists in the rest of the world. He stated that the U.S. represents one-quarter of gas consumption and that a 70-year supply is held in reserves. He qualified that most of these reserves are located far from the continent.

Mr. Bartholomew directed attention to slide showing a map that summarizes the “gas competition going on in the Pacific Basin.” He informed that Sempra Energy is discussing development with all parties representing the developments indicated on the map. He remarked, “all the developments want to bring gas to the West Coast” over the next five to ten years, as the West Coast is the only area with a rapidly increasing demand for national gas. He stated demand is not increasing rapidly in Japan, Korea or Taiwan, and that “China has its own issues”.

Mr. Bartholomew asserted that Alaska is nearest to California and is therefore potentially “the most desirable supply.”

Mr. Bartholomew stated that a number of terminals have been proposed for the West Coast; however, most are proprietary terminals specifically for parties transporting "their own gas". He explained that oil and gas companies have invested between one-half billion to one billion dollars into each project and "have a lot at stake," as do the governments associated with the developments. He pointed out that Sempra Energy is one of the few companies that are "supply neutral," not attempting to "monetize upstream reserves." Therefore, he surmised Sempra Energy is "an ideal party for Alaska to work with."

Mr. Bartholomew also told of "Atlantic Basin" competition, listing Venezuela and Trinidad as locations with the greatest advantage due to their proximity. He stated that Qatar contains one of the largest reserves of natural gas, with one field containing nearly the amount of gas used in North America today, although it is located farthest from the western coast of the U.S. He predicted that in the long term, Qatar would become a supplier of natural gas for North America.

Mr. Bartholomew overviewed a "net-back" analysis" to determine how competitive Alaska's natural gas is to the remainder of the world. He stated that based on information provided by the Alaska Natural Gas Development Authority, Alaska "seems relatively competitive" with alternatives in the Pacific Basin.

Mr. Bartholomew commented that the significant number of proposed terminals is due to "magnitude of the problem in terms of future natural gas supplies." He predicted that only "a very small fraction" would be constructed.

Mr. Bartholomew showed a slide of a map of "Baja, California and the Southwest" and pointed out the location of Sempra Energy's proposed Costa Azul terminal, located between Rosarita and Ensenada and proposal to transport natural gas to market. Although other terminals were proposed for the western coast of Mexico, he anticipated that only one would be constructed because the cost to expand a terminal is significantly less than constructing a separate facility. He furthered that Sempra Energy has obtained the necessary permits, from the federal government, the Mexican Energy Regulatory Commission (CRE), a permit from the Mexican Ministry of the Environment and Natural Resources (SEMARNAT), and a local land use permit from the Municipality of Ensenada, to construct its facility and that the other developers have not applied to land use permits due to "opposing local interests" and environmental permits. He qualified that a number of additional permits are necessary although he anticipated no difficulties in obtaining these permits. He was aware of only one proposed terminal site in California in which permits were applied for with the U.S. Coast Guard. He remarked that Sempra Energy, with the completed permits and planned construction to begin in the first quarter of 2004, is approximately one year to one-and-one half years ahead of other developers in completing a terminal. He predicted "start up" would begin in the first quarter of 2007.

Mr. Bartholomew informed that Sempra Energy would "build a lateral" from the company's existing pipeline on the northern Baja Peninsula to the San Diego Gas Transition Network to transport gas to the Western markets. He also noted an existing pipeline that runs at the California/Arizona border would be utilized to "deliver gas into the network".

Mr. Bartholomew next showed an illustration of the proposed terminal. He pointed out this is "the most isolated site" attributing Sempra Energy's success to this. He stated the site is not visible from the highway and has no neighbors and that the company purchased 400 acres approximately one year prior at an estimated cost of $600 million. He identified the location approximately one and one-half kilometers from the most southern point of a golf course.

Mr. Bartholomew informed that the permits would allow a capacity of 1.0 billion cubic feet per day (Bcfd) and although two tanks would be constructed, the company could expand 100 percent to at least 2.0 Bcfd and two additional tanks.

Mr. Bartholomew indicated additional site illustrations in his slide show presentation. He stated that other LNG suppliers have conducted helicopter "flyovers" of all the proposed sites in Mexico and agree that this site is the only viable option to "land" gas in Mexico and potential for the West Coast of the U.S.

Mr. Bartholomew told of another project Sempra Energy is pursuing in Louisiana, which has recently received a final Federal Energy Regulatory Commission (FERC) approval. He stated that construction is planned to begin in the first quarter of 2004 with start up expected in 2007.

Mr. Bartholomew expressed that Sempra Energy would not begin construction without "firm commitments for supply". Therefore, he stated the commitments must be received immediately, reminding that the company was negotiating with all suppliers located in the Pacific Basin. He noted that in some cases, government funding depends upon LNG and those governments are "extremely anxious to get their market into the West Coast" making competition "very intense". This project, he reiterated, has the highest probability of occurring. He commented that Sempra Energy has been discussion the matter with the State for two months; however

"Alaska has not been able to fully commit behind its LNG project." He warned that as a consequence, the company perceives that the State "lacks the intensity necessary to win" and Sempra Energy is thus unwilling to dedicate limited resources to Alaska. He expressed favoritism in granting the contract to the State because of low risk and "is most attractive from a supply standpoint."

Mr. Bartholomew instructed that if Alaska "wants to compete, really has to commit itself to winning and pursuing that" because of the competition. He warned that the process would not last long and asked the State to make a commitment of "earnestness" within the next two weeks. He stated that Sempra Energy could not defer or delay a decision and expected to reach a decision by the end of 2003. He spoke of discussions that must be held between the State and the company before that date, emphasizing the magnitude of the issue. He assured that Sempra Energy "would do everything it can to help Alaska but Alaska needs to first decide whether it wants to compete."

STEVE PORTER, DEPUTY COMMISSIONER AND LIAISON TO ALASKA NATURAL GAS DEVELOPMENT AUTHORITY, DEPARTMENT OF REVENUE, testified to the State's priorities with regard to stranded natural gas, a funding request from the Alaska Natural Gas Development Authority, and the State's recommendation of the appropriate role of the Authority.

Mr. Porter spoke to the Stranded Gas Development Act, which was amended the previous legislative session and provides for an applicant to propose a project to the State and allows the State to negotiate a contract with the applicant to provide "some certainty" to the State and to the applicant for revenues and added value. He reported that the Murkowski Administration was awaiting an application from the gas producers under the Stranded Gas Development Act for an Alaska Highway route project. While waiting, he informed that the Administration was "preparing internally" for negotiations of that contract.

Mr. Porter relayed that the issue is "centered around the federal legislation". He noted that a U.S. Congress conference committee was considering an energy bill that includes "important provisions" to which the State has been "an active party". He stated that a federal energy bill could provide for development of a natural gas pipeline able to transport 4.5 bcf per day of Alaska's stranded natural gas to market. He expressed the Administration's commitment to passage of this federal bill to place the State "in a position" to develop existing gas reserves, as well as any new reserves discovered in the future.

Mr. Porter explained the preference for the Alaska Highway route for a pipeline. He listed the project would maximize the value of Alaska's gas reserves as the most important element. He informed that the 4.5-bcf capacity of the pipeline would "commit" all of the State's gas reserves to market, whereas the proposed LNG project presented by Sempra Energy, would commit less than half the volume. He furthered that the Alaska Highway pipeline proposal would provide transport for all future reserves, which could include an LNG project.

Mr. Porter emphasized that producers control the gas reserves for "their preferred project".

Representative Croft interjected to request clarification of the party that controls the gas. He understood that the State has ownership.

Mr. Porter explained that under the terms, the producers would be responsible to proceed with developing the oil and gas resources. He said the leases are held for production of the oil, but the producers also have the responsibility to pursue the marketing of the gas. So long as the producers actively pursue that marketing, he informed that the State has no legal authority to take the gas from the producers. Therefore, he stressed the State's responsibility to assist the producers in marketing that gas. He relayed that currently the producers' preferred project is the Alaska Highway route to market gas to the East Coast of the U.S., as the most beneficial and economical use of that gas. He commented that the Administration is in agreement with this assessment.

Representative Croft asked if the Administration's position is that the producers have been actively pursuing a gasline for the past 35 years.

Mr. Porter replied it is not and clarified the Administration position that producers are currently actively pursuing a gas project.

Representative Croft asked if producers are actively pursuing gas projects elsewhere in the world.

Mr. Porter responded that as oil and gas companies, "certainly they are," as they hold many assets.

Mr. Porter resumed his presentation, listing another goal of the Administration to maximize wellhead price to provide a greater State return. He remarked that the Alaska Highway project would accomplish this. Given the current gas reserves and recognizing the requirements of the Alaska Highway route, he stated that another project must be a "secondary focus" until future reserves were identified.

Mr. Porter reiterated that a spur line to tidewater with the additional benefits it would provide, would “compliment” the Alaska Highway route gas pipeline project in the future.

Mr. Porter next addressed the Natural Gas Pipeline Development Authority funding request. He stated that prior to the passage of a federal energy bill, the Administration concluded that a funding request would be “premature”. He stressed the State’s focus is the passage of the federal energy bill as well as negotiating contracts with the oil and gas industry to provide gas to the East Coast of Alaska through a 4.5 bcf gas pipeline. He furthered that LNG project “is not defined” either.

Mr. Porter pointed out that the Administration and the public had not had an opportunity to assess the risks associated with the LNG project. He referenced Mr. Heinze’s presentation on discussing the risks. Mr. Porter stressed the importance of evaluating the risks, saying that expounding on the potential benefits of a project is incomplete if the associated risks are not understood. He stated that without an understanding of risks, investors would not invest in a project. He encouraged the Natural Gas Pipeline Development Authority to assess the risks of a LNG project and relay its findings to the Administration.

Mr. Porter continued that the Administration has identified other activities appropriate of the Authority at present and stated that a smaller funding request could be appropriate for consideration once the Legislature reconvenes. He listed pursuance of “a statutory obligation”, railroad tax-exempt bonds, tariffs and cost of service, Internal Revenue Service (IRS) “ruling”, the Jones Act, and tanker issues, also included in Mr. Heinze’s presentation. Mr. Porter emphasized that “those items that bring benefits to the State of Alaska should be the focus of the Authority”.

Mr. Porter concluded that many of the aforementioned activities could be conducted utilizing existing State and private resources. He stated that “a substantial amount of research” could be complied and analyzed without additional funds.

TAPE HFC 03 – 111, Side A

[Speakers were not identified during this portion of the meeting. Speakers are identified when possible through voice recognition.]

Representative Croft questioned if the project was dependent on the passage of federal legislation.

Mr. Heinze observed that the LNG project can be viewed in several ways. If viewed independently, the answer would be no: it is not dependent on federal legislation. The Alaska Natural Gas Development Authority is taking the view that the best thing for the state of Alaska is to tie the LNG project to the producer lead highway pipeline. In that sense, yes it is dependent [on federal legislation]. He did not believe that the discussions between producers and ANDGA regarding what the interaction would look like had anything to do with federal legislation. He observed that at some point ANDGA is a distraction to the process that will be taking place over the next couple of months, but are supportive.

Representative Croft questioned the chance of a long-term price of under $1.65 per NCS (notional cost of service). Mr. Heinze explained that $1.65 is the cost of service number associated with an infrastructure approach of the Gas Authority spending $12 billion on a LNG type delivery system and a zero wellhead price. Representative Croft clarified that this would be without profit.

The question is: Will California prices stay below $3.00 on a sustained basis (due to the cost of shipping and the cost to re-gas.) He did not see prices dropping below $3.25 - $3.50. He pointed out that the cost of drilling wells is rapidly escalating in the “lower 48”. He did not think that gas prices would stay below $3.50 on a sustained basis. There is not enough gas in Trinidad or Venezuela to flood the North American market sufficiently to cause the price to drop very low.

Mr. Porter observed that prices were around $2.00 in the early 1990’s, which has come up over time. The amount of stranded gas in the world is close to 6,000 TCF (trillion cubic feet). With these factors, the assumption is that people with reserves would not bring them on to flood the market and drop the price. The state of Alaska would like to see an evaluation of the risk that a substantial amount would come on to the market at a given time, which would reduce the price.

Mr. Heinze observed that ConocoPhillips had calculated Alaska LNG at a cost of service of $2.80. Indonesia is the lowest on the chart at $2.27. The odds of a flood on the market reducing the amount beyond this level are small.

Mr. Porter referred to risk factors facing the state of Alaska: the state of Alaska must pay the producers a negotiated wellhead price of reasonable value, and the sale price [is of an unknown value]. He maintained that there is more volatility to the state of Alaska than to someone who transports the gas and then markets it through a team of marketers throughout the world.

Senator Green questioned if the state of Alaska has turned over the power to distribute and sell to the developer and producer in issuing the permit for exploration and development. The state would be the recipient of the funds, but not the one that generates the sale of the product.

Mr. Porter observed that the question of who owns the gas is not settled.

Mr. Heinze thought that an offer of $1.36 to the producers by ANGDA with no risk would be attractive. The addition of $1.65 [to $1.36] would be $3.01; the probability of the price dropping below this level would be small.

Representative Croft stressed the importance of addressing who owns the gas.

Representative Whitaker asked if a substantial amount of the request for $2.5 million from Mr. Heinze pertains to risk assessment. Mr. Heinze observed that the request identifies money to do a benefit analysis and design to maximize the Alaska benefit. He is happy to work with business consultants in assessing all the risk factors.

Representative Whitaker questioned why the Administration has taken the position that the request is premature. Mr. Porter maintained that the risk assessment is not identified in Mr. Heinze's chart detailing the $2.5 million. Representative Whitaker interjected that Mr. Heinze had identified [as part of the $2.5 million request] evaluation of the work scoop and cost estimates with contractors, which would amount to identifying the cost of the project and risk assessment. He maintained that this is necessary if the project is going to have an opportunity to proceed. He referred to conversations with Jim Clark, Chief of Staff to Governor Murkowski, pertaining to the project. Mr. Clark indicated that the Administration would be in full cooperation for an additional request by the Legislature for funds.

Mr. Porter clarified that there are things that ANGDA needs to move forward, which they are in the process of doing. The premature element is not that the $2 million is inappropriate, but that the $2 million should be dealt with during the legislative session. There is nothing, which would make it necessary to make the decision immediately. He maintained that the decision should be made after federal energy legislation has been enacted.

Mr. Whitaker questioned how the Legislature should deal with Sempra's timeline and the Administration's position regarding Sempra's request. Mr. Porter noted that the Governor spoke to Sempra and the Authority [ANGDA]. The Governor recommended that the Authority come back to him with a specific recommendation and analysis of Sempra's request.

Representative Whitaker maintained that there is an inconsistency in the Administration's position. Mr. Porter acknowledged Representative Whitaker's concerns. He noted that there is an element of risk that must be dealt with as the state of Alaska proceeds forward. He suggested that the best path is for ANGDA to come to the Governor with an explanation of Sempra's proposal, along with their evaluation and plan for dealing with the proposal and a plan to evaluate the risk associated with the proposal. The Administration wants to seriously consider the issue.

In response to statements by Senator Green, Representative Whitaker clarified that he put $1.2 million in the House budget; the Administration said that they would not approve more than $150 thousand. Senator Green recalled that the Administration was talking about more than a million dollars in early conversations. She maintained that the Legislature is somewhat responsible for the final decision.

Representative Whitaker asked if the ANGDA had sat down with the Administration to make clear their needs. Mr. Heinze noted that he is a Department of Natural Resources employee and assured Representative Whitaker that conversations occur continuously. He stated that he is happy to work with the Board and make a recommendation as to proceeding with Sempra. He expressed concern that he does not have the resources to answer the questions [that will occur as a result of the recommendation]. He pointed out that his thinking has changed over the last six months, due to the dynamic situation on the West Coast. The Department of Natural Resources' approach is entrepreneurial, which could be helpful to the Legislature. He stated that if the Legislature turned to him in March or April [2004] with a direction to start work that he would not be able to meet that timeframe. He felt that efforts were compatible.

Representative Whitaker summarized that there is no conflict with congressional proposals; there is no conflict with the hoped for producer proposal regarding a gas line project; and that if progress is to be made that the risk and benefits have to be evaluated.

Senator Green questioned if the risk assessment needs to be project specific. Mr. Heinze stressed that each of the five elements of risk need to be examined separately. The biggest concerns relate to price: there is a risk of project overruns; and there is a risk that volume won't fit into the market. He visualized a marketer to minimize the volume risk and felt that a basket of prices would reduce risk. All of the supplies have to live off the same price in a basket of prices. In a rational world prices would be more incline to increase.

Senator Therriault spoke via teleconference. He stressed that the ideal situation for the state of Alaska would a project that follows the highway and serves both markets. He questioned why Sempra's timeline is so short. He observed that congressional change could occur in the next 30 to 60 days, which would lower Sempra's transportation cost. It was noted that it is a competitive business.

Mr. Heinze observed that there are many competing projects, but that Sempra's is the only one in the Baja, Mexico area that is possible to consider. Sempra is the only match for an entity like that state of Alaska that has supply and doesn't want to go too far downstream. Sempra is a marketer of consumable gas. They are also building a re-gas facility. He pointed out that Sempra is several steps ahead of the state of Alaska. He maintained that the state of Alaska needs to push forward in their commitment and questioned if the state is interested in building a LNG project, in the long-term. He asserted that, if the intent is to build a LNG project, then there is a timing mismatch between the projects. He stated that he did not know how to construct an arrangement if there is uncertainty as to the state of Alaska's commitment to do a project.

Senator Therriault asked if the potential price benefit of partnering with a highway project would allow for an extended timeline of 30-60 days.

Mr. Bartholomew stated that they were not in a situation where they could wait. Mr. Heinze emphasized that the potential commercial arrangement is unknown. If the state of Alaska partners, they lose the ability to be tax-free on that portion of the project.

Senator Therriault stated that he is supportive of the portion that would go to the tidewater. He questioned how this [route] would impact the delivery or sale of the rest of the product. He felt that staff could be hired and loaned to ANGDA to help within the existing BRU. He stressed the need for a more detailed request to the Governor regarding what needs to be done with the other items, to see if resources in other BRU's could be steered toward these efforts, as opposed to a new appropriation of $2.5 million.

Mr. Heinze stated that he has extensively scoped and estimated the cost of doing the work and it was provided in detail to the Committee.

Representative Lynn questioned which route would bring gas to market and revenue to the state of Alaska the most rapidly, with the most certainty.

Mr. Porter noted that if a route to the East Coast were developed that the majority of the North Slope reserve would be dedicated. They would hope that subsequently, with an aggressive exploration program, new opportunities would discover additional gas reserves that would provide for the next opportunity to expand to a LNG line and/or a spur line to South Central Alaska.

Representative Fate questioned if the opportunity would rise again if the state of Alaska did not act.

Mr. Freer responded that it is Sempra's view that there is a onetime shot for West Coast penetration of LNG gas in the near term. The long-term could be 10 to 15 years. It is Sempra's view that if the state of Alaska does not act in the next 30 – 60 days, that the opportunity would be closed. He stressed the length of time it has taken to bring a project forward and maintained that a receiving terminal will be built at Costa Azul in Baja California. It is up to Alaska to decide if it wants to be the suppler. There are serious negotiations with other suppliers that want the market.

Representative Lynn questioned if the Asian market was included in Mr. Freer's assumptions. Mr. Bartholomew noted that Japan, Taiwan and Korea are growing relatively slowly. Sakhalin 2 and Indonesia are much closer to those markets than Alaska; it seems likely that these suppliers would penetrate Asian markets before Alaska. He felt that Alaska would have a hard time getting into the Far East market.

Mr. Heinze acknowledged that small volumes may be placed, but emphasized the importance of the West Coast location as a true competitive advantage.

Mr. Freer noted that the Bush Administration supports the gas pipeline, but not the tax credit mechanism. He estimated that the opportunity to build the line through Canada is in jeopardy.
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<u>ADJOURNMENT</u>

The meeting was adjourned at 11:10 a.m.