

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 25, 2004

3:37 p.m.

TAPE(S) 04-16

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Fred Dyson
Senator Ralph Seekins
Senator Ben Stevens
Senator Kim Elton
Senator Georgianna Lincoln

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Hollis French
Senator Bert Stedman
Senator Donny Olson
Representative Nancy Dahlstrom
Representative Jack Coghill
Representative Hugh Fate

COMMITTEE CALENDAR

^OVERVIEW:

^MIDAMERICAN ENERGY HOLDING CO.

Presentation by David Sokol and Bob Sluder

CHAIR SCOTT OGAN convened the meeting of the Senate Resources Standing Committee at 3:37 p.m. All members were present. In addition, Senators Olson, French and Stedman and Representatives Coghill, Fate, and Dahlstrom attended.

SUMMARY OF INFORMATION

OVERVIEW PRESENTATION: MIDAMERICAN ENERGY HOLDING CO.

MR. DAVID SOKOL, Chairman and Chief Executive Officer of MidAmerican Energy Holdings Company, provided members with a description of MidAmerican. It is the second largest pipeline

company in the United States with \$19 to \$20 billion in natural gas assets. It owns 18,000 miles of interstate pipeline assets.

Berkshire Hathaway, a New York Stock Exchange Company, owns 80 percent of MidAmerican. Berkshire Hathaway owns about \$200 billion in assets, has a large amount of cash on hand, and has virtually no debt. Warren Buffett sits on the board of MidAmerican; he is supportive of this project.

In regard to what MidAmerican will bring to the table, MR. SOKOL told members the Alaska gas line will be an open-access common carrier pipeline that will handle any shipper that wants to purchase or ship natural gas to the Lower 48 in a non-discriminatory manner. MidAmerican is prepared to commit all of the equity necessary, along with its two partners, to construct, own, and operate the facility. MidAmerican has the most experience in North America with a large bore pipeline. It recently expanded its Kern River pipeline by 1 bcf/day. Due to the recognized need for the project, that 720-mile project was permitted in nine months, received full FERC certification in 11 months and was constructed in 8.5 months. It was built on time and 10 percent under budget. If MidAmerican cannot provide the lowest cost tariff to the shippers, it will not construct or own the pipeline.

MidAmerican understands the importance of local involvement and content. It has committed to using local businesses and people on all of its projects to the greatest extent possible and will do so in Alaska.

MidAmerican will be a FERC regulated owner/operator of a pipeline that must provide equal access to all participants. The project will move forward more quickly because several transactions can be worked on simultaneously. He noted the producers want a number of issues resolved, and that must occur before the project moves forward. However, the time for the pipeline is now because of the best financial climate in the Lower 48, reasonable pricing, the need for the gas, and a supportive Bush Administration.

MR. SOKOL said that he, Mr. Sluder, Mr. Dunn and Mr. Kroloff were present to introduce themselves and were not asking for anything of the Legislature.

MR. SOKOL and MR. SLUDER provided the following information in response to members' questions.

MidAmerican will have two roles: ownership, operation and construction of the asset and as the commercial party putting the entire transaction together. MidAmerican will identify the pipeline itself - from Prudhoe Bay to the Yukon border, which will connect to a new pipeline that connects with the Boundary Lakes Foothills' assets of TransCanada. The TransCanada pipeline will be expanded with looping and compression for gas delivery in the Lower 48. That structure provides the lowest cost of delivering that gas to develop the lowest cost tariff for shippers. Using that infrastructure will also allow markets of gas throughout the Lower 48 to directly participate. Purchasers will be able to directly buy gas and get it delivered to their market, rather than buy it in Chicago and transport it from there.

MidAmerican's job is to own and operate the pipeline at the lowest possible cost so that customers can buy gas at the lowest possible price and producers can netback the greatest to themselves. It will not compete with its customers by buying gas in Alaska or shipping capacity.

MidAmerican is already educating gas purchasers in the Lower 48 about the benefits this pipeline will bring in moderating gas prices there. It will also create a market for local distribution companies, high volume purchasers and states to buy capacity on the pipeline. Genuine open access will make this pipeline the greatest value for the state and will enhance its economy. By creating a market in the Lower 48 that recognizes the value of holding capacity on this system, MidAmerican hopes to have 30 to 50 shippers on this pipeline. That is important because the potential users of this pipeline do not know the advantage of signing up and buying capacity now. If all of the capacity is owned by a small number of companies, when an exploration and production company finds gas in Alaska, it could only buy access to the pipeline from a small number of companies. However, 50 shippers would create a natural market where capacity would trade between those parties. Shippers could subcontract for more or less capacity than they need at that time. That is important to credit stability and to expand the economic opportunities in Alaska. MidAmerican will participate in the process of getting customers to sign up and pairing them with producers who buy and sell gas. MidAmerican would only participate, contingent upon approval from the state and FERC. if a party is necessary to close the gap.

The Alaska gas line will be a contract common carrier so that when the pipeline is envisioned, an open season will occur

during which companies will bid on capacity rights. MidAmerican is envisioning 4.5 bcf/d. If the companies bid upfront for 5 bcf/d, MidAmerican will engage in a process to get that group to sign firm contracts on 4.5 bcf/d. Those shippers will own the capacity right for 25 years. That right can be sold or sublet. If additional shippers want access to the pipeline, it will be designed with up to 1.5 bcf/d expansion capacity through compression, which can be done incrementally.

The contracts will have two components. The majority and most important part of the contract is a demand component, or the ship or pay provision, in which the shippers pay for the capacity whether they use it or not. The second component is a commodity component that is not paid unless the commodity is shipped. The ratio is about 95 to 5.

MidAmerican's rate of return would be regulated by FERC, which ultimately sets the tariff. The components of calculating the tariff are the cost of construction, the cost of financing, operations, fuel used for compression, insurances, fees, and taxes. Any benefit the state negotiates, such as a structured payment in lieu of taxes, goes to the tariff, not to MidAmerican. MidAmerican's rate of return is regulated so that if something occurs to allow MidAmerican to make more money, it benefits the shippers. The rate of return ranges, depending on the leverage and the risk profile of the project. The Alaska gas line will clearly be viewed as a high-risk project. MidAmerican is encouraging greater leverage, which will affect that, but the debt benefits make it the right thing to do. That rate of return will be in the 12 to 14 percent range, assuming MidAmerican performs.

MidAmerican has an extremely good track record of using local hire; its most recent projects were in Utah and Nevada, where local hire ran about 60 to 70 percent. Alaska probably does not have enough union contractors to do all of the work on the gas pipeline. Local hire goes beyond the job issue; Alaska has some of the most qualified consultants who have been looking at this project for 25 years. MidAmerican plans to take full advantage of that Alaska expertise. In addition, MidAmerican plans to buy needed materials locally when possible to keep transportation costs down.

Regarding state ownership as a partner in the gas line, MidAmerican believes the risk level for the state is probably too high. However, the state should seriously consider ownership of shipping rights for royalty gas. The state might consider

buying 1 bcf/day to provide enhanced access to new participants, which would be the greatest return on investment the state could provide.

MidAmerican is not in conflict with ANGDA and views ANGDA as a customer. To the extent an LNG plant and the pipeline to Valdez are economic, MidAmerican would make them more so because ANGDA could buy capacity for the first several hundred miles for less than building a line itself. MidAmerican assumes there will be customers to take gas off for Fairbanks and Cook Inlet. MidAmerican would not participate in those actions unless asked to do so by the state.

MidAmerican anticipates completing stranded gas negotiations in mid-March and delivering gas to the Lower 48 by 2010. Construction would begin in 2007. That should give any Cook Inlet or ANGDA project plenty of time to know that MidAmerican's project is financed and moving forward. MidAmerican has looked at some of the estimates for a spur line that run several hundred million dollars. The size of the pipeline will be a function of the market the gas is going to; MidAmerican sees Anchorage and an LNG facility as making economic sense.

TransCanada and the Canadian government are anxious to go forward with this project but nothing will happen unless everything goes forward together with back-to-back agreements so that the shippers know their costs and exactly when the pipeline will be finished. In addition, the project could not be financed unless the agreements are in place. The producers want to sell their gas but at their time and price. Once consumers in the Lower 48 are prepared to sign up for shipping capacity, the producers will have to start negotiating to sell the gas or buy their own shipping capacity. The producers will do what is in their best interest but, once an outlet for the gas is contractually obvious, they will sell.

MidAmerican has heard an estimate for a bullet line of \$19 to \$20 billion from the producers but it does not believe that is the most economical approach. The first component is a gas conditioning facility on the North Slope; that would cost \$2 to \$2.5 billion. MidAmerican is prepared to build and operate that facility but did not include it in its proposal. It makes sense that the producers control that facility because they will also be able to use capacity on the TAPS line to move those liquids. The pipeline to the Yukon border will cost \$6.3 billion to construct. Another 1,000 miles of pipeline will need to be built from the Yukon border to the Boundary Lakes region of Alberta.

The entire project should cost \$5 to \$6 billion less than going into Chicago, which translates to 50 cents per mcf of delivered gas, which must be saved to make this pipeline viable. In terms of tariffs, MidAmerican believes this pipeline can deliver gas in the range of \$3.25 to \$3.50 per mcf, an extremely competitive price in today's market.

The pipeline will be 48 inches in diameter. It's possible the pipe length will be 80 feet on the northern areas but 60-foot lengths are more likely. MidAmerican will try to do more than the single random 40 foot to save on welding.

MidAmerican and TransCanada have a very good relationship. TransCanada has spent in the vicinity of \$400 million on this project for right-of-way work in Canada and other work in Alaska. Whichever way the state chooses to go, TransCanada wants to be a player. The Canadian interconnection will happen whether the project is a bullet line to Chicago or not because the rules are different at that border. That pipeline will have to go through the Canadian environmental and regulatory processes so a contractual relationship will be necessary regardless of whether MidAmerican or the producers own it. MidAmerican believes TransCanada is the most competent party to own and operate that pipeline. If MidAmerican had to build a bullet line through Canada, that permitting process would take several years. If MidAmerican chose not to use TransCanada, it would be permitting an entirely new right-of-way, which would be prohibitive time wise.

The shippers will pay three tariffs. The first is on the portion from Prudhoe Bay to the Yukon border. The second tariff will be on the new Canadian piece of pipe and the existing Foothills pipeline. That rate will be similar to Alaska's and will be put into a firm foundation. There will also be smaller, commercial tariffs for a buyer that wants to move gas to Nebraska, New York, or elsewhere. Those tariffs are already established.

The 25-year contracts with the shippers will work much like an office building lease. Parts of the contract, to be determined by FERC, will not be fixed for the entire period. Although the price will not remain constant for 25 years, the shipper will have a 25-year right to the capacity and a known pricing formula.

MidAmerican does not believe a bullet line makes sense and would argue that mixing producers with pipeline owner/operators is problematic because of potential conflicts. Those conflicts can

be sorted out but that arrangement often gives the wrong impression to other exploration and production companies.

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MidAmerican normally does not have partners in its pipelines but it believes having business partners that know Alaska is of value. Berkshire Hathaway has had a long relationship with CIRI. Pacific Star Energy encompasses CIRI and the other Native corporations; CIRI felt it was a logical additional partner. The 19.9 percent was established based upon U.S. tax law: a company must have 80 percent ownership to take advantage of more rapid depreciation. 20 percent of equity in this project could equal \$800 million.

MidAmerican has agreed to complete negotiations with the Stranded Gas Committee by March 12. The contract will then be available for public comment and legislative consideration. That process must be completed in that timeframe so that MidAmerican can complete about \$14 million of environmental work this summer, otherwise its overall schedule will be delayed one year. The issue to be discussed under MidAmerican's proposal is the state's tax regime. Most of the negotiations will be about timelines and dealing with rights-of way and permit applications. The producers' negotiations will be more complex.

Regarding LNG that will be shipped to the United States over the next 10 to 20 years, most of it will come from areas where an above ground pipeline was built near to an LNG facility so the pipeline is an almost inconsequential cost of the LNG process. The uniqueness of the Valdez project is the expense of that interconnection. However, MidAmerican has no concern with 1 bcf per day going to Valdez to be processed into LNG. MidAmerican will be able to get 6 bcf per day off of its 48 inch line with compression - the first 1 bcf will come off after a few hundred miles. There will be additional stations north of Fairbanks to accommodate the additional 1 bcf.

Producers around the world typically want to control the conditioning facility because they are best suited to deal with the products they want to bring off that gas. There are two places to put a conditioning facility - in Alberta or the North Slope. MidAmerican believes the better place is the North Slope because of the existing infrastructure. Use of the Mackenzie gas in the tar sands may have changed Canada's interests in this arena.

Regarding the need for a dehydrating plant on the North Slope, an existing conditioning plant removes CO₂, nitrogen and water but it would need to be expanded to treat basic contaminants. A liquids processing treatment plant would remove butanes, hexanes, and heavy gases, and liquefy them for injection into the oil pipeline. To transport those heavy liquids in the gas line would require a wet-phased pipeline. MidAmerican plans to run a dry gas pipeline. The gas will be a little hotter than normal but within normal specifications and will be suitable for heating fuels for homes.

MidAmerican has an AAA credit rating and built a pipeline closest to this size within the last 10 years. Its relationships with FERC, the Department of Energy and the EPA is very good. The pipeline's time has come - the economics and market conditions came clear a year ago. The energy markets do not stand still. There is clearly a supply and demand balance issue in the Lower 48 that will get resolved with or without Alaskan gas. MidAmerican believes this project is the best resolution as the economic benefits will remain within the U.S. and it will be more secure. However, if gas prices continue to rise, demand will diminish and move offshore. The window of opportunity to commercialize Alaska's gas is 18 to 36 months and it will take every minute to do it. Purchasers would prefer to buy from Alaska rather than foreign sources. The time to sign long-term agreements is now.

MR. MARK KROLOFF, Chief Operating Officer of Cook Inlet Region, Incorporated (CIRI), endorsed the comments made by Mr. Sokol and Mr. Sluder.

ADJOURNMENT

NOTE: The meeting was recorded and handwritten log notes were taken. A copy of the tape(s) and log notes may be obtained by contacting the Senate Records Office at State Capitol, Room 3, Juneau, Alaska 99801 (mailing address), (907) 465-2870, and after adjournment of the second session of the Twenty-Third Alaska State Legislature this information may be obtained by contacting the Legislative Reference Library at (907) 465-3808.