ALASKA STATE LEGISLATURE
JOINT OVERVIEW
SENATE RESOURCES STANDING COMMITTEE
HOUSE RESOURCES STANDING COMMITTEE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS
March 30, 2005
2:37 p.m.

MEMBERS PRESENT

SENATE RESOURCES

Senator Thomas Wagoner, Chair
Senator Ralph Seekins, Vice Chair
Senator Kim Elton
Senator Bert Stedman
Senator Ben Stevens

HOUSE RESOURCES

Representative Jay Ramras, Co-Chair
Representative Ralph Samuels, Co-Chair
Representative Gabrielle LeDoux
Representative Jim Elkins
Representative Carl Gatto
Representative Kurt Olson
Representative Harry Crawford
Representative Paul Seaton

HOUSE OIL AND GAS

Representative Vic Kohring, Chair
Representative Ralph Samuels
Representative Nancy Dahlstrom

MEMBERS ABSENT

SENATE RESOURCES

Senator Fred Dyson
Senator Gretchen Guess

HOUSE RESOURCES

Representative Mary Kapsner

HOUSE OIL AND GAS

Representative Lesil McGuire
Representative Norman Rokeberg
Representative Berta Gardner
Representative Beth Kerttula

COMMITTEE CALENDAR

Overview: Nenana Basin Gas and Oil Project

BOB MASON, Vice President, Exploration, Andex Resources Corporation

SEAN PARNELL, Deputy Director, Division of Oil and Gas, Department of Natural Resources (DNR)

BOB SWENSON, Petroleum Geologist, Division of Geological and Geophysical Surveys, Department of Natural Resources (DNR)

MITCH USIBELLI, Manager, Usibelli Energy

TOM DODDS, President and CEO, Andex Resources Corporation

JIM MERY, Doyon Corporation

TONY IZZO, President, Enstar Natural Gas Company
JOHN LAU, Director, Transmission Operations, Enstar Natural Gas Company

DAN BRITTON, President, Fairbanks Natural Gas

JOE BEEDLE, Vice President, Finance, University of Alaska

ACTION NARRATIVE

CHAIR THOMAS WAGONER and CO-CHAIR JAY RAMRAS called the joint meeting of the Senate Resources and the House Resources Standing Committees and the House Special Committee on Oil and Gas to order at 2:37:08 PM. Present were Representatives Ramras, Olson, Gatto, Elkins, Crawford, and Senators Elton and Wagoner.

OVERVIEW: NENANA BASIN GAS AND OIL PROJECT

BOB MASON, Vice President, Exploration, Andex Resources, said a tremendous opportunity exists because there is so much gas in the Nenana Basin. Usibelli Energy, Doyon Corporation and Arctic

Slope Regional Corporation are partnering with Andex for development of approximately 10 tcf. Gas could be provided to the Anchorage area and ultimately, when the new gas pipeline comes down from the North Slope, along the TAPS, to Fairbanks.

He highlighted the similarities between the rock formations in the Nenana Basin and the Cook Inlet where folds of rock about 20 miles below the surface allowed gas hydrocarbons to be formed in the Tertiary period. The strong potential for gas combined with a nearby natural gas market makes development of this site very attractive.

High quality data was gathered by ARCO and Shell, which Andex combined with all the other information that has been gathered by the state, the USGS and various academic institutions. It created a tremendous "data set" indicating that the Nenana Basin has significant potential. If this information had existed in any basin in the Lower 48, industry would have drilled evaluation wells years ago. Because of where the Nenana Basin is located, industry recognized it as a gas prone basin; but it just wasn't economic to produce it in the early 80s. Now it's a different story.

MR. MASON said that Andex was issued an exploration license in October of 2002 for 480,000 acres. It has four years remaining on the primary term and it has the option to convert that acreage to leases with another seven-year term. This provides Andex with the time it needs to evaluate and develop the Nenana Basin and they have committed to spending $2.5 million on new exploration work there. If it is successful, Andex would go to its partners, Usibelli Energy, Doyon Corporation and the Arctic Slope Regional Corporation (ASRC), and attempt to get them to agree to an exploration drilling program to begin by 2006. If successful then, they could be in the development phase in late 2006 or early 2007. First gas sales could be in Fairbanks by late 2008.

He emphasized how geographically strategic the Nenana Basin is and how absolutely critical that was to Andex's decision to go forward with an exploration program. If the reserve base is large enough, a pipeline could be built along the Alaska Railroad Right of Way into Anchorage.

3:03
SEAN PARNELL, Deputy Director, Division of Oil and Gas, Department of Natural Resources (DNR), introduced BOB SWENSON, Petroleum Geologist, Division of Geological and Geophysical

Surveys, who covered the state's oil and gas activities in the Nenana Basin. He said that of all the basins, the Nenana Basin clearly has the majority of the subsurface information, which is critical for an exploration program. The state's exploration license program provides exploration companies with an incentive to go into areas that have not been explored or have had very little exploration. Test wells that have been drilled have been on the outside of the formation and he cautioned that one of the critical risks of drilling in the formation is the possibility that the gas hydrates will become trapped and, therefore, inaccessible.

3:10
MITCH USIBELLI, Manager, Usibelli Energy, said he is very enthusiastic about the project and the potential to diversify his company's energy resource base.

TOM DODDS, President and CEO, Andex Resources Corporation, explained that the company is privately owned and the owners have been in the oil business since the 1950s. They feel the Nenana Basin has great potential for gas and oil, but it is a high-risk area and operating in Alaska is expensive. They have a two and half month a year drilling season and have barely finished seismic operations this year. Andex will start working with the various state departments on permitting wells within the next 30 to 40 days.

3:16
JIM MERY, Doyon Corporation, said that Doyon worked to get the project kick-started and helped Andex put together an exploration license on the adjacent state lands. Doyon's board liked the project so much that it decided to invest hard cash in it.

3:18
TONY IZZO, President, Enstar natural Gas Company and JOHN LAU, its director of Transmission Operations, said Enstar serves nearly half the state's population and owns and operates 3,000 miles of natural gas pipeline. It is the largest distribution company and largest utility in the state.

The transmission pipeline arm of Enstar is called the Alaska Pipeline Company (APC) and it has constructed and operated over 450 miles of high-pressure transmission pipeline and 2,600 miles of distribution lines. This represents 75 percent of all transmission pipeline in the state right now for natural gas and 100 percent of the distribution lines. Of great concern to them,

assuming nothing new is discovered, is that the Cook Inlet gas supply and demand graphed lines intersect in 2012.

3:25
MR. IZZO said that all home heating and power generation gas requirements are met until 2008. If customers, for some reason, had to flip to using fuel oil, the next cheapest source of fuel today, that would represent a $300 million per year increase in the cost of their energy. This estimate does not include the cost to convert to that fuel – about $5,000 to $10,000 for an average home. Enstar already has to scramble to provide power on high-use days and its strategy is to contract for additional supply. Changing from an excess supply market to a supply and demand market has changed the way that supply is negotiated. Department of Energy (DOE) surveys indicate that sixty-five percent of customers favored a spur line from the north rather than local natural gas development.

3:31
The estimated cost for developing onshore gas is $5 billion to $6 billion with the costs being recovered through the rate-payer. That much money could also advance a pipeline pretty far north where proven reserves of natural gas are 35 tcf and would serve the area's total needs for a few hundred years.

3:36
JOHN LAU, Director of Engineering Transmission Operations for Enstar, talked about what it takes to build a medium-sized pipeline. Eighteen percent of the 63 bcf Enstar produces is used internally and of the remaining, 90 percent is used for residential use and 10 percent for commercial.

3:35
MR. LAU said a conceptual study of a spur line from Fairbanks to Cook Inlet will take 18 months and will include everything from right-of-way leases and permitting to construction contracts and ordering equipment. Building the pipeline is estimated to take two years. Towards the end of the construction process the RCA would review and determine tariff issues. The year 2009 is not an unrealistic date to look at for needing more supply and the time to start doing the study work is right now.

Enstar is in the conceptual study process right now. It is partnering with the Department of Energy, ML&P, Chugach Electric, ANGDA and the other state agencies to determine what type of lease they would get for the right-of-way. It is also sizing the pipeline and looking at storage options.

3:43
MR. IZZO concluded adding that they figure the pipe will be 24 inches with compression potential for future growth.

3:45
SENATOR SEEKINS asked why anyone would do any further exploration in Cook Inlet if it is so expensive and how would Enstar make up the gas deficit in the meantime.

MR. IZZO replied that he basically feels Enstar's mission is to bring the lowest-cost dependable energy to the consumer as possible. If Nenana Basin gas is developed, their plan would not be to fill up their requirements 100 percent with it since potential natural disaster and federal regulation makes potential emergencies too costly. Enstar's contracts are continuously layered for reliable service without relying too heavily on just one source. It's possible that they might fill requirements long enough that other companies might be discouraged from going forward with any new activity.

CO-CHAIR RAMRAS asked what it would cost to build 50 miles of transmission lines to Fairbanks.

MR. LAU indicated that a 12-inch line could be built for around $700,000 to $800,000 per mile and a 24-inch pipe, which would be more suitable for future growth, was estimated to cost around $1.5 million per mile, plus or minus 20 percent, two years ago.

CO-CHAIR RAMRAS asked what kind of demand from Fairbanks would be needed to justify building a transmission line from Nenana to Fairbanks.

MR. LAU replied that the full potential for Fairbanks would be 27 bcf per year - 9 bcf would be residential and commercial and the other 18 bcf per year would be if power generation, including military generation, were on natural gas. The Fairbanks market is as big as Enstar's market is right now in Southcentral.

3:58
DAN BRITTON, President, Fairbanks Natural Gas and Northern Eclipse LLC, said they have a liquid natural gas facility in Pt. Mackenzie that liquefies Cook Inlet gas and trucks it to Fairbanks for the heating market. They deliver about .6 bcf per year to a little over 700 Fairbanks customers and see strong market growth. The challenge has been to compete with fuel oil

markets in Fairbanks and their customers will save money when converting to gas. Reheating and transportation costs that they now have would go away when a pipeline is built and gas is cleaner and very versatile to use compared to fuel oil. He projected 85 percent of their customers would convert from fuel oil to gas in the Fairbanks area.

REPRESENTATIVE RAMRAS asked what comes first, production or infrastructure.

MR. IZZO responded that Enstar would have a two-year build out in the Fairbanks region starting with the skeleton infrastructure and going from there. The transporter would contract with the supplier/developer and the seller.

CO-CHAIR RAMRAS asked if a $50 million pipe were built from the Nenana Basin to Fairbanks before transmission lines were built to residential and commercial users, how much gas would have to go through for tariff to be bearable.

MR. IZZO replied that once the study was mature, they would know what the expected rate of return would be and what tariff would be acceptable. It would not be difficult to solve.

CO-CHAIR RAMRAS asked how many miles of pipe would go to Cook Inlet.

MR. LAU replied that a 24-inch pipe would be a little more than 300 miles long and operate at 1,400 psi.

MR. BRITTON expanded that in Fairbanks for every mile of distribution, coinciding LNG infrastructure has to be built. Fairbanks Natural Gas is spending more on LNG infrastructure than on distribution, but that will change when the infrastructure is finished. If it had more supply, its market would increase significantly.

CO-CHAIR RAMRAS asked what comes first – the production or the infrastructure.

MR. BRITTON replied that Fairbanks Natural Gas would continue to expand its system with an LNG supply as well as expanding its existing distribution backbone in Fairbanks, but they are ready for gas supply at any time.

CO-CHAIR RAMRAS asked the producers what the relationship is between the producer and the people who build the pipe. He

specifically asked if it was a friendly relationship or adversarial.

MR. IZZO replied that Enstar's process is that once something has been identified to sell, they enter into an agreement on supply, which varies depending on the amount of gas being negotiated. A recently approved contract to serve Homer, for instance, says that the producer must produce a certain amount and his company is required to build a line to Homer.

CO-CHAIR RAMRAS asked what the Legislature can do to facilitate the process.

MR. IZZO replied that the permit process could be accelerated. Right now their estimates are optimistic.

4:15
MR. MASON added that Andex is still in the high-risk exploration phase and part of their problem is the short time frame of two and half months in which they actually operate in the Nenana Basin. The most important thing would be to be able to extend the current tax-incentive program into the exploration phase.

MR. DODDS added beyond that, a quick response time on permits is very important in order to have the time to get drilling rigs and other exploration equipment where they need to be when they need to be there. Otherwise they have to wait one additional year before drilling any wells. The cost of their drilling has increased 50 percent in the last year in the southern part of the United States. He said the state could also allow for drilling other than in January, February and the first part of March, depending on where a lease is located.

SENATOR WAGONER directed his comment to Mr. Parnell saying that he assumed no one in the department would be taking extended vacations.

MR. PARNELL responded that the department hasn't experienced those difficulties, but he is willing to work with any company that is.

JOE BEEDLE, Vice President, Finance, University of Alaska, said that it benefits from education and research associated with activities in the Nenana Basin. In addition, the university consumes several million dollars worth of energy resources each year and the potential of Nenana gas is exciting. Secondly, as the university is a land grant university, he is awaiting the

outcome of HB 130, which transfers 250,000 acres to it. The most exciting single parcel is the 90,000 acres in the Nenana Basin, which represents approximately 20 percent of the licensed acreage area. The university would own the subsurface and surface estate and be entitled to the 12.5 percent royalty associated with the acres under license.

CO-CHAIR RAMRAS thanked everyone for their presentations and adjourned the meeting at 4:25 p.m.