

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 14, 2011

3:32 p.m.

MEMBERS PRESENT

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Hollis French
Senator Gary Stevens

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel
Senator Joe Thomas
Senator Linda Menard
Representative Eric Feige

COMMITTEE CALENDAR

PRESENTATION BY ENERGIA CURA

- HEARD

PRESENTATION ON ALASKA NATURAL GAS TRANSPORTATION PROJECTS BY
LARRY PERSILY, OFFICE OF THE FEDERAL COORDINATOR

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

ALEXANDER GAJDOS, Managing Partner
Energia Cura LLC
Anchorage, AK

POSITION STATEMENT: Presented overview of Energia Cura's
proposed natural gas pipeline project.

DIANE BENSON, Fairbanks Pipeline Company (FPC)
Subsidiary of Energia Cura

POSITION STATEMENT: Provided overview of the proposed Arctic Fox Natural Gas Pipeline Project.

LARRY PERSILY

Federal Coordinator for Alaska Natural Gas Transportation
Projects

Washington, D.C.

POSITION STATEMENT: Provided comment and update on Alaska natural gas pipeline projects.

ACTION NARRATIVE

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CO-CHAIR JOE PASKVAN called the Senate Resources Standing Committee meeting to order at 3:32 p.m. Present at the call to order were Senators Stedman, French, Wielechowski, Stevens, Co-Chair Wagoner and Co-Chair Paskvan. Senator McGuire was excused.

Presentation by Energia Cura

CO-CHAIR PASKVAN announced that Energia Cura would give a presentation on a proposed natural gas pipeline system to deliver affordable gas from Prudhoe Bay to Interior Alaska and perhaps to Southcentral Alaska. The question has been how do the citizens of Alaska and, primarily, the ones who live very close to the North Slope receive any benefit when it comes to heating their homes, businesses and schools. One of those concepts is a small-diameter pipeline, and such is Energia Cura's thought.

ALEXANDER GAJDOS, Managing Partner, Energia Cura LLC, introduced Diane Benson, who joined their team recently.

DIANE BENSON, Fairbanks Pipeline Company (FPC), said she would provide an introduction on behalf of the company which was founded by Energia Cura and a talk about the Arctic Fox Natural Gas Pipeline Project.

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She said FPC was founded for a single purpose, to build a small-diameter in-state pipeline that would bring gas from the North Slope to Fairbanks and closer to other Alaskan markets in a sooner rather than later timeframe. The goals of Arctic Fox Natural Gas Pipeline are to lower energy costs, improve air quality, net the highest value, retain wealth in Alaska, and

provide investment opportunities for Alaskans and use the best transport methods for the gas.

She said the project is unique in a number of ways. Unlike other projects, the Arctic Fox line will compete in a market environment defined by 50 percent avoided cost factors. She explained that private oil and gas marketing, pricing and margins strategies are based on what markets can bear. FPC's goal is not focused on finding or resolving attainable profits; rather it is to bring Alaska residents affordable gas while keeping retained earnings circulating in the local in-state economies. This goal is notable but it is also "thinking out of the box," she said.

MS. BENSON said gas is more expensive to transport than crude oil when viewed on an energy equivalent basis, but it is also a lower-cost commodity than crude and because of that, any gas pipeline installed to move ANS gas should be owned and controlled by Alaskans. She said Tom Chapman and Alex Gajdos, the founding partners of Energia Cura, are intent on putting an end to Alaska's expensive path of trying to choose an option, and they have funded this development to date. It cannot be said enough that a pipeline to serve Alaskans can be built by Alaskans, and a pipeline sized to match ANS gas' utility value can be constructed without state subsidies.

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The Arctic Fox Pipeline project and the Alaska Holding Company provide an opportunity for Alaskans to not only profit through dividends (which they estimate will be about 11 percent per year), but to know that Alaskans are contributing to Alaska's future together. She said the Arctic Fox natural gas pipeline can be built within the width of the Dalton Highway, which is designated 200 feet at its minimum.

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MS. BENSON also mentioned that Arctic Fox does not rely on exporting. Their objective is to provide for Alaska's needs for to benefit Alaskans. A relatively simple gas pipeline easement like those granted in many other states is preferable to both the state of Alaska's long term interest and the project's timeline.

She said FPC wants to get gas headed to Alaskan markets ideally by 2014; every day they delay moves that date forward. So they may be looking at 2015 depending on how this legislative session goes. It is within the state's power to provide access to the

easement and the state's boring and geological data as well as assistance with environmental permits regarding an existing corridor. She said the owners of the Fairbanks Pipeline Company are businessmen with long history and experience, and who care about the future of the state.

She said the members of the company would reap their own benefits from the pipeline in the same way that other Alaskans and Alaskan companies will profit and that is with the purchase and ownership of shares including receipt of annual dividends.

MS. BENSON reasoned that the state has certain obligations to Alaskans under constitutional law and statutes to make determinations in the best interests of the state. The state's Dalton Highway master plan states that one of the goals for its plan is to maximize economic development opportunities for Alaskans. This is an opportunity to move a project forward and show that Alaska is a business friendly state.

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MR. GADJOS said this is their first time to the table and he hoped "to spark a little fire" and get another invitation to go deeper into the project details. He explained their concept of "utility value" goes beyond the single or two dimensional management approaches to resource extraction where all that gets looked at is tax and royalty. The idea of Alaskan pipeline ownership is what they bring to the table, he said, as well as the idea of keeping as much of the wealth it generates in the state and increasing it over time. He said their goal is also to lower Interior Alaska's non-discretionary energy costs.

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CO-CHAIR PASKVAN asked him to go through case 1 on slide 10.

MR. GADJOS explained that case 1 is a 12-inch line from Prudhoe Bay to North Pole through Fairbanks to distribute the 19 bcf that FPC has nominated. Because the concept is for a transmission system selling its gas to major load centers there are essentially only eight customers. He said Fairbanks already has a gas distribution utility of less than 1 bcf/year, but other parties are interested in outbuilding that line.

He said Kevin Banks, Department of Revenue (DOR) deputy commissioner, recently projected price increases from \$5-13 in the Cook Inlet in the next decade, but FPC believes it to be closer to \$10 in 4-5 years. FPC did some modeling increasing the line to 18 inches (at a cost of \$287 million) and installing a

blind flange that would be capable of supporting the entire Cook Inlet load today.

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SENATOR FRENCH said their estimate for constructing an 18-inch pipeline from Prudhoe Bay to North Pole is a little over \$1 billion and yet that is substantially less than other estimates for similarly sized pipes. He has seen numbers as high as \$7 billion (to Anchorage), and he asked Mr. Gadjos to explain why he can build a pipeline for that much less.

MR. GADJOS replied primarily because they use a small bore; Senator French's numbers are for a 24-inch line built by Alaska Gasline Development Corporation (AGDC) that would cost \$3.8 billion. The market for that project is 70 percent larger than what the Cook Inlet market is today, and that is intrinsically tied to exportation. That project includes significant capitalization for processing facilities and a tide-water LNG plant for exports, which he didn't think was feasible given global gas economies. In most other places in the world condensate-rich gas reserves are already at tide water.

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SENATOR FRENCH said the AGDC pipeline to Fairbanks cost \$3 billion and on top of that they include \$2.5 billion for a gas treatment plant, and asked how his plan would treat the gas.

MR. GADJOS replied their figure of \$4.22 [mcf] includes gas treatment and compression stations. Their CAPEX is all about pipe, which is 12 inches in the case 1 scenario and 18 inches in the case 2 scenario.

SENATOR FRENCH asked if FPC would be paying extra for the gas at Prudhoe to include the treating.

MR. GADJOS replied yes. They are negotiating with the producers and have received three proposals for skid-mounted compressor stations and treatment facilities. Their findings indicate whether they build it or the majors build it on the North Slope that their CAPEX would be roughly equal. Existing resources can be leveraged better than a third party could treat gas making long trips to the market conduit. Over time it amounts to a significant amount. In the Lower 48 the market risk amounts to 34 miles; up here it's more like 518 miles.

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CO-CHAIR WAGONER asked him for a breakdown of his \$4.22 mcf figure for treating the gas on the Slope.

MR. GADJOS said he hoped his negotiations could shave that price a little bit. The average over last year in the Lower 48 was about \$3.67.

SENATOR STEDMAN asked for a brief synopsis of where his project is and what impediment is stopping him from building the line.

MR. GADJOS responded that his model shows the state participating up to 7.2 percent, another slice of it owned by the people nominating the gas, another slice owned by Alaskan companies, another slice owned by the larger Native corporations, and about 38 percent left over to be owned by the general public. They are offering \$100-shares that will be administered through their banking partner (similar to opening a bank account). The shares will not be publicly traded; the principal component will remain fixed over time and it will return dividends of approximately 11 percent to the shareholders. Their model has a 20-year amortization schedule and the design life of the project is 65 years.

CO-CHAIR WAGONER and asked if they had selected any contractors for this project or made any agreements with construction contractors like Bechtel - since the project was supposed to come on line in 2014.

MR. GADJOS replied that he has worked with both engineering firms and construction firms at arm's length in developing some of his numbers. The reality is that building a road-side pipeline of 12 or 18 inches will take two full winter seasons.

He said they are not asking for subsidies, but they are suggesting that the state make assets like its geophysical data available to these engineering firms so they can start detailed engineering. They would be working for through FPC's bank affiliate, whose in-kind contributions would be nominated through par-shares at \$100.

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MR. GADJOS said the "state's sanction" would invigorate in-kind participation. If they don't get that, within about a month and a half their project will be delayed until 2015. The risk is from volatile steel prices that were double in '08 of what they were in '09, and since have crept back up by about 32 percent. Their pipe quotes are from November, and since steel is the

project's major expense, the longer they wait, the more the CAPEX goes up.

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CO-CHAIR WAGONER said he remembers the TAPS line that was going to cost \$900 million to build and ended up costing close to \$8 billion and asked why he and his partner feel they can stay at this level. It looks like a tight budget to him. Even though they are offering shares, part of the project will have to be financed and what would those people have to say about that.

MR. GADJOS directed him to a set of power points on their website called "sensitivity analysis" that ran different cost scenarios in different phases of the project.

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CO-CHAIR PASKVAN said this small diameter pipe from Prudhoe to the Interior is a very interesting project and thanked him for his presentation.

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At ease from 4:19 to 4:22 p.m.

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**Presentation on Alaska Natural Gas Transportation Projects by
Larry Persily, Office of the Federal Coordinator**

CO-CHAIR PASKVAN called the meeting back to order at 4:22 and welcomed Larry Persily, Federal Coordinator for Alaska Natural Gas Transportation Projects.

LARRY PERSILY, Federal Coordinator for Alaska Natural Gas Transportation Projects, said his title is a long way of saying his job is to represent the federal government to help get a pipeline built to take gas to Alaskans and the Lower 48 states. He said he would give them an overview of where he sees the potential for a gas line, the state's involvement in it, and a brief summary of the report he issued last week.

He said a North Slope natural gas pipeline is possible, but it will take the right market conditions, investors willing to risk tens of billions of dollars, and it will take state participation. The right market conditions could come as the nation's electric utilities convert from coal to cleaner burning natural gas. More demand would drive the need for more supply which would give Alaska gas a chance in the market place.

If investors see demand building in the years ahead, if they see higher prices for gas in the decades ahead, Alaska has a chance to compete against shale gas. At some point, Alaskans will have to decide how much they want the pipeline and what the state's fair share is, measured not just by how much wealth they expect from the state's share of the gas, but what the state would look like without any wealth to share. The reality is the North Slope has thrived on oil, only oil and nothing but oil, for 34 years, but it will not continue thriving without a way to get gas to market.

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MR. PERSILY said a gas pipeline serving the huge North American market would make Alaska a much more attractive option for the tens of billions of dollars needed to maintain the aging oil pipeline, to pump more oil from older fields, and to explore for new reserves. Adding up the investment dollars, the goods and services bought in Alaska, the jobs, tax and royalty revenues, and a gas line could help provide a strong economy for decades to come. It's not just about counting the last tax dollar but about a state with a future or a state running out of oil money.

He knows Alaskans are frustrated with the pace of the gas line development, but the reality is that big projects always take longer than expected. While waiting for the results of the two gas pipeline open seasons that closed just six and four months ago, his office decided it would be helpful for people to have some numbers to ponder and some policy issues to consider as they look at the state's fall-back option of underwriting a small in-state gas line. He and Roger Marks, a contractor, had been working on the report since last summer - about as long as the open seasons. It was not intended to pick a fight with the in-state gas line, but to promote discussion and maybe "to stir things up a bit" so Alaskan's would know their choices, the costs, and the options; so that when the time comes they could make the best decision for the state's future.

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Then he said the direct and indirect benefits to the state and its residents of a large-volume North Slope natural gas pipeline to serve in-state and Lower 48 markets would be substantial. Tax and royalty revenues would be significantly higher than from a small in-state gas line. A large-volume main line to the Lower 48 markets would spur increased investment in new oil and gas exploration in Alaska and the pipeline tariff for gas deliveries within Alaska would be substantially smaller with the economies of scale of a large pipeline.

He said the report also reviews the opportunity cost to the state of a potential subsidy of a small in-state line versus the option of possibly applying the same amount of state leverage to a larger main line project. And if state involvement could mean the difference as to whether the main line is ever built, the state would be far better off committing the equivalent investment in some form or another toward the main line project rather than as an in-state pipeline subsidy. Their report determined that even if you could sign up large-scale industrial customers to justify building an in-state pipeline carrying 500 mcf/day from Prudhoe Bay to Southcentral, the state would have to kick in an estimated \$4.2 billion toward construction costs - to end up with gas at the end of the pipe equivalent to the \$7-plus/mcf that Enstar paid on average for Cook Inlet gas last month.

MR. PERSILY said that analysis made several assumptions including that you pay producers \$2/mcf for the gas and that the state subsidy came as a one-time grant to help cover construction costs. It also contemplated the idea of cutting the state subsidy in half if Southcentral customers would spend 25 or 30 percent more than they did last month for gas.

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He said in terms of revenue to the state, an in-state line at 500 Mmcf/day would generate an estimated \$326 million/year in royalty, production tax, property tax, and corporate income tax revenues to the state. That assumes private ownership of the line, no change in state tax rates and gas worth \$2/mcf at the wellhead. He said they used those same assumptions and looked at the line carrying 4.5 bcf/day mostly to Lower 48 markets plus whatever is needed to meet in-state demand. That project would generate \$2.3 billion/year in public revenues, again assuming no change in the state's tax rates, and the likelihood that the state would need to do something with its tax structure to help the economics of the project. The North Slope gas line has a chance, but the economics are tight and risky.

MR. PERSILY summarized that if Alaskans believe in a better future with a pipeline bringing gas to Alaskans while creating jobs and billions of dollars in new public revenues, it's time while they wait for the open season results to look at what the state can do to help move the project's economics in favor of construction - not a subsidy, not an open-ended financial incentive with nothing in return, but rather sitting down with

all the parties to look at the problems and finding answers. He said his office is willing to help with that.

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SENATOR WIELECHOWSKI said Mr. Persily's analysis assumed oil and gas had been coupled and asked why he made that assumption when that legislation was vetoed last year. And what would be the impact of gas remaining coupled to oil on his numbers.

MR. PERSILY answered that they debated a lot about that issue and decided to decouple because it's cleaner and the truth is that it depends on the price discrepancy of oil and gas. They assumed decoupling with all expenses assigned to oil. He assumed if there ever was going to be a gas line that there will have to be "some sort of decoupling."

SENATOR FRENCH said his report does not address distribution costs, a particularly acute problem in Fairbanks, and asked what it would cost Fairbanks consumers to install a gas distribution center.

MR. PERSILY replied they hadn't looked at that, but last week he talked to John Davies, Cold Climate Housing Research Center at the University of Alaska Fairbanks, that had some preliminary numbers indicating "it's not as expensive as you think." He explained that federal law requires mileage-based tariffs on an Alaska gas line. So, gas as far as Fairbanks is only going to pay the tariff for the miles from Prudhoe Bay to Fairbanks, and their estimates working off the numbers from the open seasons, if you pay \$2/mcf on the Slope and you pull the gas out in Fairbanks with another \$2 and change for treatment and tariff, making it "pretty affordable gas." But it would still need to get from that main pipe into town and distributed.

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SENATOR STEDMAN said he would have to look at those numbers, because he wasn't that comfortable with drawing the conclusion that an in-state gas line would not in effect have a negative impact. The political and tax consequences of that would fall on Alaskan consumers along with other complications. Mr. Persily's message seems to mean if the state is looking at a \$4-billion subsidy for an in-state gas line, it might be better off owning \$4 billion worth of a \$40-billion pipe.

MR. PERSILY responded that he was careful not to propose what the state would do with its \$4-billion investment, because that would be federal interference in state affairs. But he didn't

necessarily see the \$4 billion as equity. The report says if the state is prepared to write a \$4-billion check, why don't you see if you can get something more for it other than a small-diameter line that doesn't produce much revenue. The state could look at things like deferring property taxes during construction or deferring production tax revenues during some early years and things that do not involve taking an equity stake or writing a \$4 billion check but could improve the economics. It could be argued that a reduction in state revenues today could be recovered later on in the project.

SENATOR STEDMAN said some of those concepts were already negotiated under the Murkowski administration. "We'll have to wait to see what comes out of the open seasons if, in fact, we get to know what some of the concerns and requests are that are imbedded in both the Denali and AGIA process. That won't be till summer at the earliest."

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SENATOR WIELECHOWSKI said he agreed with a lot of what Mr. Persily said in terms of moving the gas along the big line as far as possible saving on tariff. The problem is that people in Fairbanks are paying \$2000/month for heat and hundreds more for electricity, and oil is projected to be \$100/barrel for the next several years. No big line is in our sights for at least a decade. Cook Inlet has gas but can't get it to market. The problem he sees is the 10-15 years. The advantage of a small-diameter pipeline is if you can get it built quickly, you can provide some relief to a significant population for probably a 6-7 year period. He didn't know if Fairbanks could go on for another decade without some sort of relief.

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MR. PERSILY responded that he didn't think a small-diameter line could be built that quick but if private enterprise wants to build something, no one is stopping them. His point is, long-term, where they see the state's economy, and without a way to get gas off the North Slope, oil investment up there looks a lot less attractive. The state has had a good run for 34 years off oil and without a gas line that won't happen again. The problem is immediate energy needs of Fairbanks and Bush Alaska. With the LNG plant closing in Kenai and storage hopefully coming to Southcentral, he hoped they would be okay. The immediate problem may be energy costs in Fairbanks, but long term it's going to be public revenues in the bank to pay for all the services the state provides. A small-diameter pipeline isn't going to do that.

SENATOR STEDMAN referred to the PPT discussions a few years ago when some argued that taxes under ELF should be the benchmark for energy and some argued that the international market place should be the benchmark going forward. And that made the PPT discussion problematic from the get-go. He wasn't so sure they weren't also making a benchmark error in talking about the gas and energy needs into the Anchorage area and mentioning a 20-30 percent increase. Anywhere else in Alaska it's three times that, even in Southeast. If they do use the Anchorage scenario as a benchmark, that begs the question, "What about the other areas if it's Fairbanks or Southeast or Western Alaska, and how do we treat those?"

MR. PERSILY said that is the prerogative of the legislature, but to treat them they will need money, and the only way they will get any money is to have a big pipeline moving gas off the North Slope. As far as the variables he discussed, Table 1 on page 8 of the report shows if instead of using the \$7-dollar gas delivered to Enstar they use \$9-dollar gas in Southcentral then the subsidy can be cut in half. Southcentral has done very good on energy prices compared to other places in the state. He just picked some numbers and then showed the variables. He remarked that the report was a good one but it wasn't comprehensive. The total budget for it was under \$6000.

SENATOR STEDMAN said dealing with Homer on a btu equivalency that electricity at 14 cents/kWh would be four times the price of natural gas. Southeast has cheap hydroelectric. Again, he said you have to look at your starting point. The cost of energy in Anchorage is extremely expensive; the same for Fairbanks. He said they must have a discussion on a net energy equivalency basis across the state and adjusted for degree days.

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SENATOR WIELECHOWSKI went to a different topic and asked Mr. Persily to give them an assessment of the pipeline and AGIA.

MR. PERSILY responded that his office has no preference for AGIA; they track it as a gas line. The world has changed for natural gas since the legislature passed AGIA. But Alaska has a problem; on gas it doesn't really matter what the price is today, but what the companies think it will be in 20 years. If the nation pushes more toward gas instead of coal-fired - that demand depends on federal legislation, EPA, and court challenges - but it is being built already. A lot of utilities are converting. If the demand builds enough the question now is if

Alaska can get gas to market in 2020/22 at the same price of the next shale play. That is possible, but the state would have to restructure its finances to allow it to get in at a competitive price. That is what the companies are looking at now.

He emphasized that TransCanada and ExxonMobil, and the bidders are not talking about the state fiscal system; it's not in their purview. They are talking about other conditions like project delays, cost overruns, and permit problems and who pays for them. It also depends on national policy (clean air and coal versus gas) and the economics. The only thing the state can affect is the economics. Development of shale depends on what kinds of limitations are imposed on it; it's plentiful and it's technically recoverable. Whether it is economically recoverable under new water quality restrictions and other limitations put on it by states might affect its recovery.

SENATOR WIELECHOWSKI remarked that Mr. Persily's report says don't invest in a small scale line, but how do the economics of shale gas compare to the economics of an Alaskan gas pipeline.

MR. PERSILY replied it depends on which shale play one is talking about. You need a lot of water for the hydraulic fracturing of gas - anywhere from 2-5 million gallons per fracing operation. Is it available cheap and can it be disposed of cheap? There is no set price for shale. Looking ahead, it's like logging or anything else - the early stuff is the cheap stuff. Ten years from now it won't be as cheap to produce shale. There will be further advances in fracing and horizontal drilling, but water disposal and land costs will go up.

He revised his earlier statement saying before the state writes a check for \$4 billion, why doesn't it just see if somehow it could use that to make a difference and get something more. And if you can't, go for it.

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CO-CHAIR PASKVAN thanked him for his comments and adjourned the meeting at 4:48 p.m.