HOUSE FINANCE COMMITTEE
March 17, 2014
8:49 a.m.

8:49:10 AM

CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 8:49 a.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Mark Neuman, Vice-Chair
Representative Mia Costello
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Cathy Munoz
Representative Steve Thompson

MEMBERS ABSENT

Representative Tammie Wilson
Representative Lindsey Holmes

ALSO PRESENT

Larry Persily, Federal Coordinator, Alaska Natural Gas Transportation Projects.

SUMMARY

OVERVIEW: GAS MARKETS

8:49:41 AM

^GAS MARKETS OVERVIEW

8:50:01 AM

LARRY PERSILY, FEDERAL COORDINATOR, ALASKA NATURAL GAS TRANSPORTATION PROJECTS, discussed the PowerPoint, "Alaska LNG, Does the market need us?" (copy on file).

Mr. Persily highlighted slide 1, "The world changed, not us."

Global LNG trade has quadrupled since 1995

Asian LNG demand alone could double by 2025

China demand growing double-digit annual rate

Europe looking for alternatives to Russian gas

Worldwide concerns over coal, nuclear plants

Alaska LNG could be the victor of circumstances

Mr. Persily discussed slide 2, "Global LNG trade grows fast." The growth in LNG demand was attracting hundreds of billions of dollars of worldwide investment in export projects. The global LNG import demand in 2013 totaled approximately 32 billion cubic feet per day. The gas that moved as LNG across the world was only 10 percent of global natural gas consumption. Approximately 90 percent of natural gas consumed in the world was moved by pipeline.

Mr. Persily addressed slide 3, "Asian LNG imports increased 2011 to 2012." He stressed that various areas of the world purchased natural gas, but Asia made up 70 percent of global demand. The real growth potential was in China. In December 2013, China's LNG demand was up 20 percent from December 2012. China had some shale gas reserves, but had not conducted much exploration. Much of their shale gas was in arid, dry areas of the country, and hydraulic fracturing required a substantial amount of water.

Mr. Persily looked at slide 4, "China's domestic gas supply deficit." He remarked that China had been producing more than enough gas to meet its own demand, but could not keep up with their own economy. China imported roughly has of its gas by tanker and pipeline, and paid, on average, almost $10 per thousand cubic feet for pipeline gas from Turkmenistan; more than $10 per thousand cubic feet for gas from Uzbekistan; and $12 per thousand cubic feet from Myanmar. He stressed that those costs did not include the cost to bring the gas to the cities.

8:56:02 AM

Mr. Persily highlighted slide 5, "Global gas prices diverge." The slide illustrated what has changed in gas prices and transportation. He remarked that prices began to split off five or six years prior. He stressed that the prices would not last forever, and stated that most analysts expected the gap to continue widen enough to make a profit.

Mr. Persily displayed slide 6, "Enough business to share."

Worldwide natural gas demand is forecast to grow faster than any other energy source

In addition to 12 LNG export projects under construction, more will be needed by 2025

As many as 10 or 12 more in next decade

Several hundred billion dollars in investment

Cost competitiveness will decide the winners

Mr. Persily highlighted slide 7, "Price is everything."

Japan paid $70-plus billion for LNG in 2013

Energy a big reason for $112 billion trade gap

Third year in a row of trade deficit in Japan after more than 30 years of a trade surplus

Japan leading the charge for new suppliers, more competition and lower LNG pricing regime

But prices must be enough to justify investment

Mr. Persily discussed slide 8, "No project has it easy."

BG Group says 525-mile natural gas pipeline to Prince Rupert, BC, could cost up to $10 billion

LNG tax debate under way in British Columbia

Dredging, harbor, berthing costs estimated at $1.5 billion for Australia’s Wheatstone LNG

Russian politics out ahead of project economics

Buyers hold back, wait to see LNG pricing trend

Mr. Persily looked at slide 9, "Canada eager, but delayed."

First Nations want to consult on air quality, pipeline routing, economic and jobs issues

High development costs at remote gas fields

Pipelines 300 to 525 miles; 2 mountain ranges

Access to Prince Rupert may have to go offshore

Provincial tax and regulatory regimes delayed

No project has all its permits, customers and FID

Mr. Persily addressed slide 10, "Lower 48 faces hurdles."

Tough politics between producers & customers

Oversupply holds down prices for gas buyers

Producers want freedom to seek best market

Energy Department export approvals are slow

Unknown Panama Canal tolls worry LNG buyers

Local opposition to Maryland, Oregon plants, and against fracking as source of gas production

Mr. Persily discussed slide 11, "Australia and Russia, too."

Cost overruns in Australia scare investors

Contentious debate is growing that exports are driving up prices for Australian customers

Environmental, economic issues stacking up

Russian gas comes with politics attached

Distance from gas, distance from market a problem for at least two Russian LNG projects

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Mr. Persily highlighted slide 12, "Alaska has its advantages."

Proven gas reserves; no exploration risk

Low-cost production vs. greenfield projects

Almost 40 years experience at Prudhoe Bay

LNG plant much more efficient in cold climate

Shorter LNG carrier voyages to Asian markets

North Slope gas high Btu value fits the market

Mr. Persily addressed slide 13, "Alaska has changed, too."

Prudhoe Bay growing older, economics look better as an oil and gas play rather than oil only

Point Thomson under development and would supply 25 percent of the gas for the LNG project

Major North Slope producers willing to spend significant money to advance the LNG project

Alaskans appear willing to consider investing significant state money into the huge project

Mr. Persily looked at slide 14, "Patience is a virtue."

Patience is a must for state LNG investment

Long wait for the first check – but long payback

Norway invested billions in oil and gas and then waited years for any return; it took a decade before real investment payback started to roll in

If it wants to act like an oil and gas business, Alaska must think like one – and think long term

Mr. Persily addressed slide 15, "What's changed since 2002."

Department of Revenue 'Risks and Rewards' report in 2002 looked at a pipeline, not LNG

Different markets, sales, risks and regulations

State is in a better cash position today ($17 billion in savings) than 2002 ($2 billion)

State equity investment in 2002 might have needed assistance from the Permanent Fund

100 percent state ownership was on the table in 2002

Mr. Persily highlighted slide 16, "Some things haven't changed."

DOR 2002 report recommended the state match pipeline capacity with its share of the gas

Report said conflicts as an owner and regulator are real, but state-owned corporation could provide a partial barrier to minimize the conflicts

Minority ownership doesn't give state control

Report warned: Keep politics out of the business

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Mr. Persily discussed slide 17, "Big step for Alaska."

Role of risk-taking owner much different than watching as a tax-collecting observer

Provides state a voice in project decisions

Provides return to state on its investment

Capital draw concurrent with budget deficits

State shares risk of overruns, delays, prices; shares in rewards of gas and public revenue

Co-Chair Stoltze remarked on two separate phrases: cost-competitiveness will decide the winners; and price is everything. He wondered why Alaska could compete globally,

and queried the advantages. Mr. Persily stressed that the presentation was based on his opinion. He stated that the advantages included the tanker ships, that the liquefaction plant would put Alaska at a great advantage. He stressed that Alaska had proven reserves. In Australia, there was a plan to buy third party gas before their gas could be produced. Alaska had lower cost feed gas. He pointed out that Alaska was a proven producer, and the Asian market valued that historical success.

9:16:52 AM

Co-Chair Stoltze queried how tax policy worked viability worked into the markets. Mr. Persily shared that there was probably no tax regime anywhere in the world that the oil and gas industry loved. British Columbia had proposed a new net income tax on LNG exports, but they allow the companies to recover all their capital up front. The tax would go from 1 percent to 7 percent after cost recovery on that capital expense.

Co-Chair Stoltze wondered if Alaska had the patience necessary to make a proper business decision. Mr. Persily replied that Alaskans must learn patience, because of the substantial yearly investment that was required for the eventual success of the project.

Co-Chair Stoltze wondered if perhaps an increase to pre-K should wait a few years.

Representative Costello looked at slide 4, and wondered if the trend would continue. Mr. Persily replied that he felt that the trend would continue. He stressed that the air quality in China was the worst in the world.

9:21:51 AM

Representative Costello wondered if there were plans to outfit China's coal plants with clean coal technology. Mr. Persily replied that there were some efforts towards clean coal technology, but stressed that there were limits as to how clean one could make coal. He stated that if gas had a good price, it was a better deal than trying to clean coal.

Representative Costello pointed to slide 10, and remarked that one of the bullets showed that export approvals were slow. She relayed that there were regulations that ensured

environmentally safe practices. She asked if there were any delays that were anticipated with the project. Mr. Persily replied that the biggest delay that was the Department of Energy approval to export LNG to countries that the U.S. did not have free trade agreements, including China and Japan. For decades, there were few regulations in the Department of Energy. Recently there were many approvals and regulations that were required for resource export and development. He remarked that there was a contentious debate in the Lower 48 over what to do with the natural gas wealth, but that debate would not extend to Alaska. He hoped that the LNG licenses would get stalled in the debate.

9:25:38 AM

Representative Costello queried the importance of the high BTU content. Mr. Persily responded that, in Japan, their generators were set to burn at a higher BTU value than the United States. The Alaska gas stream should fit perfectly in the Japanese market.

Co-Chair Austerman stressed that the price of gas was tied to the price of oil in Alaska. He pointed out that gas in the lower 48 was not tied to the price of oil. He queried the cost of Alaska's LNG compared to the costs from other producers in the world. Mr. Persily responded that it would cost more to liquefy the gas, than it would to transfer it through the pipeline. On the U.S. Gulf Coast, it was close to $5 per thousand cubic feet at Henry Hub. He stated that there was one plant under construction in Louisiana that had signed a contract at $5 per thousand cubic feet, plus 15 percent more for the burned gas, plus $3 for the liquefaction charges, plus the tanker charges; so the total gas would be close to $12 per thousand cubic feet by the time it has landed. He relayed that the buyers were looking for something cheap and without the volatility of the U.S. prices. The alternative in Asia would always be oil, but have some sort of hybrid pricing.

9:31:57 AM

Co-Chair Austerman wondered if there was some discussion regarding the cost of oil because of the competitive nature of gas. Mr. Persily replied that there were many analysts that believed oil could go to $80 or $90 per barrel. On a

BTU basis, under current pricing formula, there would be a substantial price for LNG.

Co-Chair Austerman remarked that the liquefaction was the most expensive aspect of developing LNG. He stated that the tidewater in the Kenai gave opportunity for the rest of the state to have off takes in taking gas that was not liquefied, and therefore should be competitive in the energy market. Mr. Persily agreed, and furthered that Alaska would be pulling off a few percent for the instate needs. He stressed that the economies of scale should give Alaskans a good opportunity for affordable gas.

Co-Chair Austerman wondered if the pre-FEED work would give Alaska a sense of the price. Mr. Persily felt that pre-FEED would only identify the larger hurdles, but it would not determine the cost of the contracts.

Representative Gara remarked that there was a balance of benefitting Alaskans with affordable gas that would net export money, and independent explorers that would discover economic gas. He shared that the last iteration of the pipeline stated that there would be rolled in rates for expansion of the gas line. He wondered what could be done to increase the chances of securing contracts with independent producers to get their gas into the pipeline. He also queried the definition of rolled in rates. Mr. Persily responded that the chances of an independent producer increasing the BTU were very slim, because it was a very substantial amount of gas. He stated that there was a better chance of a newly discovered field using gas to produce oil for many years, and would only bring millions of cubic feet a day. Not billions. He stressed that Prudhoe Bay and Pt. Thompson did not have enough gas to keep the pipe full, and felt that the second decade of the project would show a decrease in production. The industry partners were banking on the possible discoveries of trillions of cubic feet of additional gas, because they need the gas to keep the pipe full for forty or fifty years. He felt that the discussion should be focused on initial building of the pipeline, and focus on expansion later.

9:40:35 AM

Representative Gara understood that compression would be the cheapest way to expand the pipeline. He wondered if there was a problem for a new producer to put gas in the

pipeline, if there was no option to expand. Mr. Persily replied that it would be difficult if the cost of expansion was greater than what was desired. He stressed that it was difficult to plan for unknowns, but understood that there should be a consideration of how much the pipeline could be expanded by compression stations and how much that would cost.

Representative Gara queried the benefits and detriments of the state taking its gas in kind as opposed to in value. Mr. Persily replied that there was trust in the company to sell the gas at the highest price possible in value and give a fair return. He stated that the in kind take would requirement a contract to market the gas. The risk with in kind was that there would be a bad marketing deal.

Representative Guttenberg looked at slide 17, and noted the large steps for Alaska. He wondered what was lost when Alaska gave up its sovereignty and becomes a partner with the industry. Mr. Persily did not understand how Alaska gave up its sovereignty.

Co-Chair Stoltze felt it may be a political term. Mr. Persily felt that Alaska would not give up its sovereignty in the agreement.

9:45:27 AM

Representative Guttenberg wondered how the division of marketing and partner would work in the agreement. Mr. Persily replied that the departments would work together, but knew that there was a responsibility of government to enforce the laws, even if it would drive up costs. He felt that there should be thoughtful discussion, so all involved realized that the issues were fully addressed.

Representative Guttenberg wondered if this was similar to Norway's model. He wondered what kind of hurdles that Norway faced. Mr. Persily replied that Norway had state-owned companies, but stated that Norway had a different political situation than Alaska. He stressed that Norway was extremely disciplined. There was a stoic virtue of behaving, and no one disrupted that.

Co-Chair Stoltze stressed that Norway was a nation, not a state.

Representative Guttenberg remarked that Alaska would have a 25 percent ownership in the pipeline, which gave Alaska a minority voice. He wondered how minority voices succeeded in enforcing their points that may not be in the overall best interest. Mr. Persily replied that votes may be lost, but at least the argument was voiced.

Representative Guttenberg remarked that one major source of gas to China was pipeline. He queried the source of that gas. Mr. Persily replied that most of the gas came from Turkmenistan, Uzbekistan, and Myanmar. The pipeline gas to the Canadian border was priced somewhere around $10 to $12, and the average price paid for LNG imported into China in 2013 was $11.80.

9:50:48 AM

Representative Guttenberg noted that the Canadian proposal would hook into Alaska's pipeline. Mr. Persily responded that the proposal was to bring oil from Alberta. He felt that the proposal was not economic, and very expensive.

Representative Thompson remarked that there were a couple of consultant reports that stated that the proposal was a radical shift from the state's current situation. Mr. Persily agreed that the proposal was unusual, and he was not aware of another state that had a similar situation. He did not feel that the state was not giving up regulatory authority. He remarked that the state would be both competing and contracting. He had not seen a better plan for bringing the AKLNG to market. He understood that the proposal was highly unusual, but stressed that the benefits and risks should be carefully examined.

Representative Munoz queried the effect of oil tax policy changes on the gas pipeline. Mr. Persily responded that the oil companies depended on an attractive tax environment.

Co-Chair Stoltze felt that there were many impacts of tax policy.

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ADJOURNMENT
9:57:04 AM

The meeting was adjourned at 9:57 a.m.