

HB

8



Representative Harry Crawford

HB 8

Sponsor Statement

HB 8 enables the state to buy the actual pipe to be used for the natural gas pipeline. Specifically, it directs the Department of Transportation to purchase the approximately 800 miles of 48" diameter steel that will be used for the in-state segment from the North Slope to the Canadian border. The state can then negotiate with TransCanada to re-sell the pipe to them when it is ready. This provides five distinct benefits:

- By re-selling the pipe years later at our cost, the state can hedge against expected increases in steel prices.
- By exchanging the pipe for an equity stake in the gasline, if desired, the state can share in the future benefits of the pipeline and be party to all management and tariff discussions
- By showing a concrete commitment to spend our own money, the state reduces industry uncertainty about our commitment to this project
- By procuring 2 million tons of steel in a weak economy, Alaskans can in one stroke provide a major stimulus to retool and modernize the American steel industry, and
- **Perhaps most important, by reducing the builder's cost, it would reduce the pipeline tariff by up to twenty cents.**

That small tariff decrease, multiplied by the volume of the pipeline, would increase the wellhead value of the gas and add hundreds of millions of dollars to state revenues every year. The value over time of that additional revenue will actually be more than the interest we would have lost if we kept that \$2 billion in savings for the intervening years.

In recent years, there has been historic inflation in the price of steel. With the rapidly industrializing economies of China and India, there is every indication that world steel demand will continue to grow and prices will increase well beyond the rate of inflation.

However, the current economic downturn has temporarily depressed steel prices worldwide. It is a buyers' market, but this will not last indefinitely. The State of Alaska has the opportunity to lock in these low prices and take advantage of the market.

According to Tony Palmer of TransCanada, enough steel to build the in-state portion of the pipeline will cost about \$2 billion. We can put that money to work for our pipeline and for America, and can earn a profit in the process.



Representative Harry Crawford
House District 21

House Bill 8: Tariff and Revenue Model for "Buy The Pipe" Scenarios

Assumptions

Construction cost and timing per TransCanada AGIA application
 Daily Volume mmcf 4,500
 Yearly Volume tcf 1.64
 State Discount Rate 5%
 State purchases steel in 2009 and delivers it to pipeline builder in 2015
 Option 1: State gives pipe to pipeline builder at no cost
 Option 2: State sells pipe to pipeline builder at state's original cost
 Capital cost \$2 billion

Scenario 1: 5% Annual Cost Inflation for Steel

	Tariff Estimate	Additional Yearly Wellhead Value (\$millions)	Additional State Yearly Revenue (\$millions)	Additional 25 Year Revenue (\$millions)	Additional NPV5 25 Yrs (\$millions)	Cost to State (\$millions)	Net Benefit (\$millions)
Baseline (Black & Veach)	\$4.73	\$0					
Give pipe at no cost	\$4.37	\$591	\$203	\$5,081	\$2,865	\$2,000	\$865
Sell pipe for cost	\$4.63	\$164	\$56	\$1,412	\$796	\$680	\$116

Scenario 2: 8% Annual Cost Inflation for Steel

	Tariff Estimate	Additional Yearly Wellhead Value (\$millions)	Additional State Yearly Revenue (\$millions)	Additional 25 Year Revenue (\$millions)	Additional NPV5 25 Yrs (\$millions)	Cost to State (\$millions)	Net Benefit (\$millions)
Baseline (Black & Veach)	\$4.73	\$0					
Give pipe at no cost	\$4.31	\$690	\$237	\$5,928	\$3,342	\$2,000	\$1,342
Sell pipe for cost	\$4.57	\$263	\$90	\$2,258	\$1,273	\$1,174	\$100

Scenario 3: 10% Annual Cost Inflation for Steel

	Tariff Estimate	Additional Yearly Wellhead Value (\$millions)	Additional State Yearly Revenue (\$millions)	Additional 25 Year Revenue (\$millions)	Additional NPV5 25 Yrs (\$millions)	Cost to State (\$millions)	Net Benefit (\$millions)
Baseline (Black & Veach)	\$4.73	\$0					
Give pipe at no cost	\$4.26	\$772	\$265	\$6,634	\$3,740	\$2,000	\$1,740
Sell pipe for cost	\$4.52	\$345	\$119	\$2,964	\$1,671	\$1,543	\$128

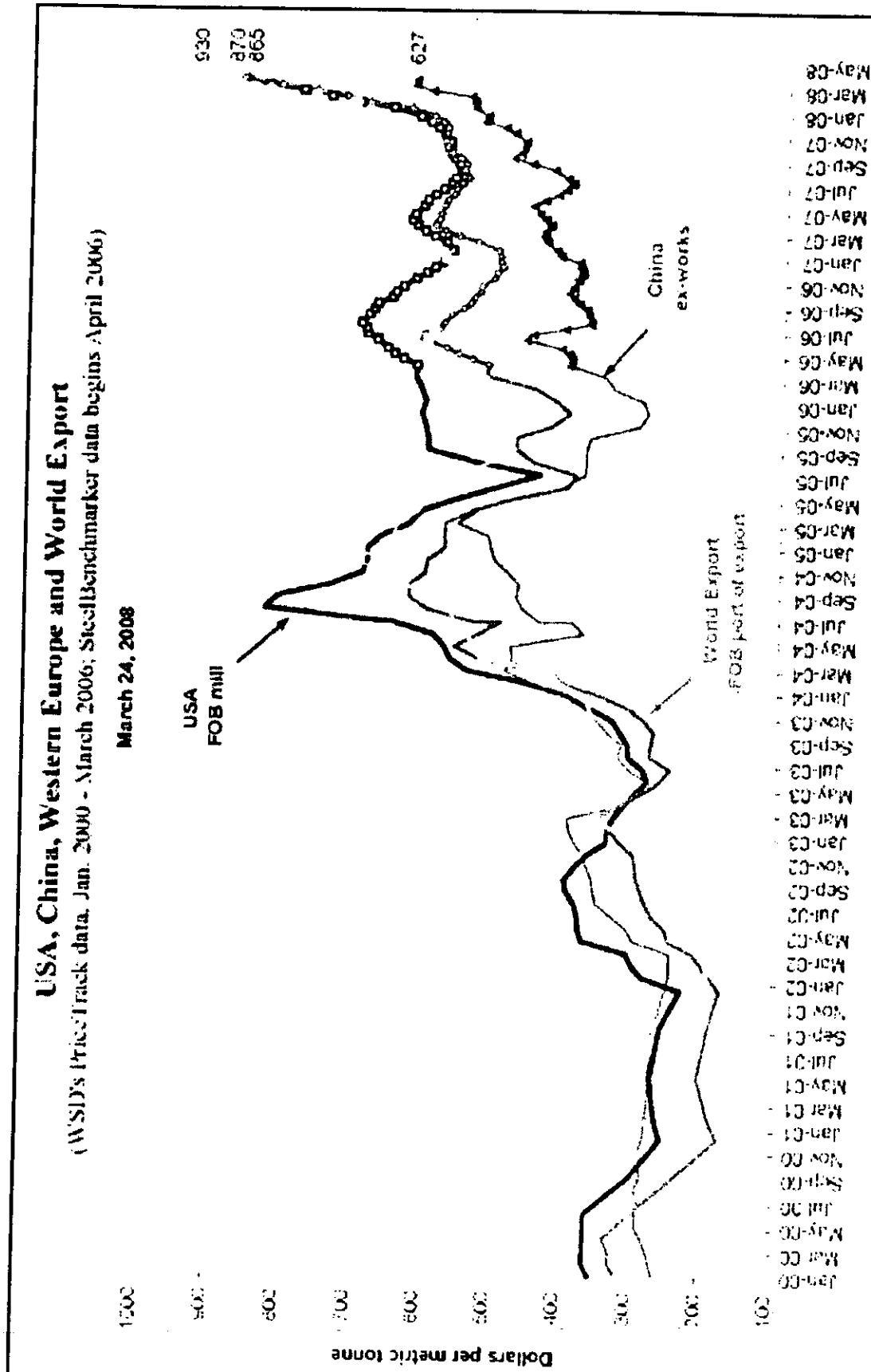


Figure 26 -- SteelBenchmarker™ HRB price.
Source: World Steel Dynamics, American Metal Market, Metal Bulletin.

Iron & Steel Technology wishes to thank Goldman Sachs Global Investment Research and SteelBenchmarker™ for sourcing the majority of data presented here.

Rep Harry Crawford- Backup Info for HB 8

http://www.engineerlive.com/Oil-and-Gas-Engineer/Interview_Opinon/North_American_large-diameter_pipe_orders_under_pressure/21399/

Oil & Gas Engineer - Interview Opinion

North American large-diameter pipe orders under pressure

Date: 28/01/2009

With significant declines in the commodities and energy complex, North American large diameter pipe-makers will experience a slowdown. K C Chang reports.

Going into the first half of 2009, IHS Global Insight does not expect a rebound in new pipe orders until oil and natural gas prices gain traction and credit markets improve.

The Alaska Department of Natural Resources estimates natural gas reserves along the North Slope region to be 35.4 trillion cubic feet (tcf), which equals roughly 6.3 billion barrels of oil.

Despite possessing proven natural gas reserves, the lack of cost-effective transportation prevents Alaskan gas from reaching consumer markets. Through the first half of 2008, the rapid acceleration of oil and natural gas prices spurred efforts to develop US energy infrastructure. The historic highs in oil and gas prices also encouraged energy projects located in the Tar Sands region of Alberta, Canada.

The two proposed infrastructure projects would extend across the arctic terrains of Alaska and Northern Canada. In particular, the Mackenzie pipeline would start near the Beaufort Sea and extend 800 miles to Edmonton, Alberta. The Alaska Natural Gas Transportation System would involve connecting the already-built Trans Alaska Pipe System to a 2140 mile pipeline system starting in Prudhoe Bay and ending in Edmonton, Alberta. The completion of both pipeline projects would ensure the effective delivery of North Slope and Mackenzie Delta gas to Tar Sands refineries and US consumer markets.

Constructing the steel pipe used for these infrastructure projects is no ordinary feat. Since both pipelines will operate in arctic terrains subject to permafrost, the proposed steel gas pipes must withstand harsh weather conditions. In particular, there is a growing demand from energy firms for X-100 and X-120 grade steel pipe that is 48 inches or larger in diameter. X-100 and X-120 are specialty steel alloys consisting of nickel, chromium, molybdenum, niobium, titanium, and copper.

Currently, X-100 and X-120 grade steel pipes are manufactured solely by Nippon Steel and Mitsui. These two grades of specialty steel possess high strength and toughness capable of withstanding fractures from cold weather, as well as high-pressure industrial usage.

The approval of both pipeline projects would place North American specialty steel mills at full capacity for several years. Large diameter pipes such as X-100 and X-120 grade are still in the developmental stages, and in North America there is a small list of firms with the capability. In particular, Berg Steel Pipe, along with Ipsco and Oregon Steel Mills (which are now part of Evraz Group SA), are known for constructing specialty high-diameter pipe. Since the development of X-100 and X-120 steel pipe is an ongoing venture, North American pipe-makers currently offer large diameter pipe with X-70 and X-90 steel grades. Given the global economic slowdown and commodity price decline, specialty steel firms are experiencing waning demand. As buyers continue to re-evaluate the financial viability of both infrastructure projects and attempt to locate financing in tight credit markets, specialty steel mills wait for orders. **While there is a small pool of qualified steel mills, demand for large diameter pipe will remain low until current economic conditions begin to stabilise.**

Through 2009, IHS Global Insight does not expect large diameter pipe prices to increase.

Current production contracts were negotiated in 2006 and 2007, when commodity prices were high and steel mill capacity was low. Although steel mills are currently completing previously negotiated pipe contracts, there is minimal new order activity. The recent price correction in energy and base metal markets will influence price negotiations for 2010 and 2011. In particular, IHS Global Insight expects a two-fold effect of lower input costs and reduced pipe demand. If oil remains in the \$40-50/barrel range, the Tar Sands energy complex may experience declines in investment demand and thus lower demand for Mackenzie Delta gas. While a decline in large diameter pipe demand and lower production costs will create significant downward pricing pressure, that pressure might be somewhat muted by producers' unique market position. Since only three to five steel firms possess the ability to construct large diameter pipe with such stringent technical requirements, the steel mills will still maintain a fairly high degree of leverage in future contract negotiations. That said, despite the current pessimistic outlook for global economic growth and energy prices falling from their historic highs, North American energy firms will still be preparing for a future demand surge.

Meanwhile, OPEC has agreed to abide by September 2007 production quotas, cutting approximately 500000 barrels per day of existing production.

OPEC's decision to go back to the future on quotas came as something of a surprise, but the overall effect (cutting 500 000 barrels per day, b/d, of production) is in line with expectations. In a statement released in the early hours this morning, OPEC agreed to abide by September 2007 production quotas, with adjustments made due to the exclusion of Indonesia and Iraq, and the additions of Angola and Ecuador. Member countries were urged to strictly comply with the quotas, which OPEC stated at 28.8 million b/d overall. Once again, OPEC did not publish specific country-by-country targets, but from OPEC's statements it appears that the move reinstates the 27.25 million b/d target that was published (briefly) in September last year, with the subtraction of Indonesia (leaving OPEC) and the addition of Angola and Ecuador (which formally joined OPEC at the end of 2007). Overall then, this amounts to a cut of 500000b/d by Saudi Arabia, which in May and then June announced unilateral output increases of 300000b/d

and 2000000b/d respectively. Latest estimates have put Saudi production at approximately 9.5 million b/d compared with the September target of 8.94 million b/d.

Expectations prior to the meeting were that OPEC would unofficially trim back production levels that had unofficially increased over the course of the last few months as the Saudis responded to prices that had risen in excess of US\$140 per barrel (/b). The reference to September 2007 quotas was rather unexpected, but actually amounts to much the same. What is curious once again is OPEC's refusal to publish country-by-country targets. In September last year they did publish these targets, but they only remained on OPEC's web site for one day, before being taken down. Prior to this the last official country-by-country targets were published in 2005. It does suggest there may be some internal questions over the country allocations that are still not resolved. In assessing the numbers based on the September 2007 publication however, it appears that the change simply removes Indonesia from the quota system. If the Saudis retract the May and June output hikes, that will bring OPEC back in line with the September 2007 quotas.

This decision comes in response to the rapid fall in crude oil prices, which have tumbled from a peak of US\$147/b in July, to a low of just over US\$100/b yesterday.

Outlook and Implications

OPEC's decision will help to firm up oil prices over coming weeks, but is unlikely to be enough to reverse the downward price trend.

What OPEC has done is signal to the market that oil is now approaching a price level close to the minimum that will be accepted. Iran and others have talked about establishing a price floor at US\$100/b, but this move suggests that the organisation would be willing to see prices drift lower, particularly given the weak global economic outlook.

Further action from OPEC is likely to come no later than the first quarter of 2009 given the current market balance, though the usual provisos about supply disruptions apply as ever.

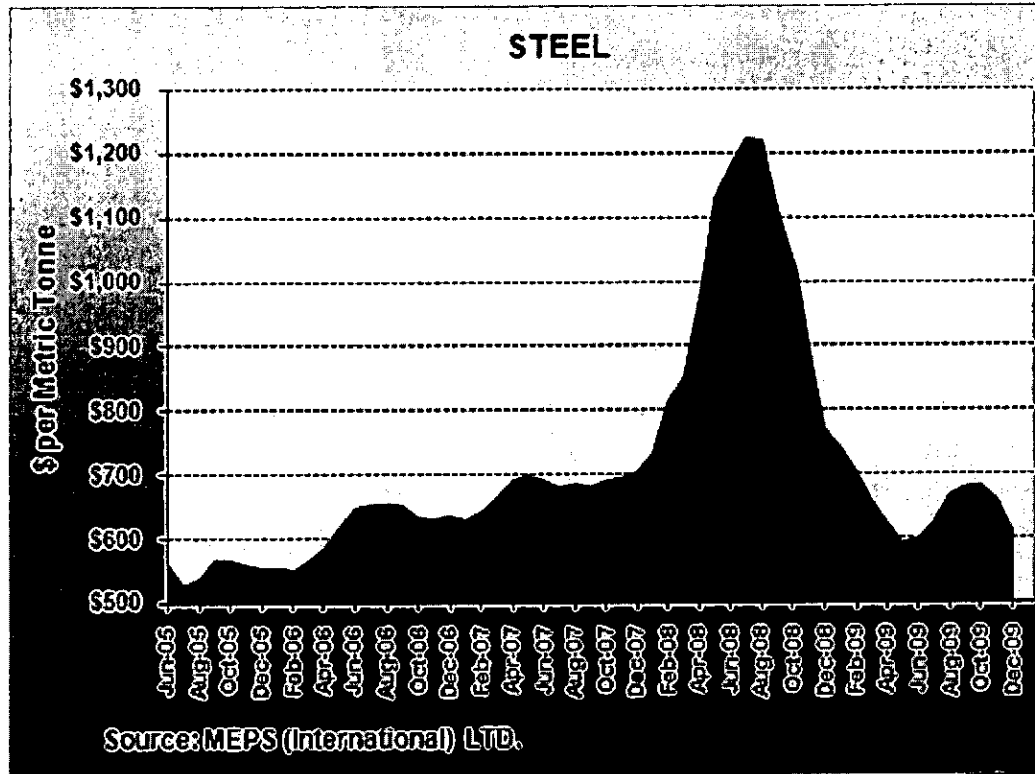
However, one further aspect of this move is that it does significantly increase the amount of spare capacity available. This in itself will go some way to reducing any price premium on oil due to geopolitical risks.

The spare capacity figure is still some way off the levels enjoyed for most of the past three decades, but it is rising again, and will continue to rise through 2009.



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Steel Prices



Connectors	Impact
Metal Circular	High
Plastic Circular	
RF	
Board-to-Board	
Backplane	
I/O	
Terminal Blocks	

Capacitors	Impact
Aluminum	Med
Ceramic	Low
Tantalum	Low
Film	Low
Mica	Low
SMT	Low
Metal Clad	

Resistors	Impact
Wirewound	Med
Trimmers	Med
Metal Film	Low
Networks	Low
Carbon	Low
SMD	

Other Products	Impact
Inductors	Med
Ferrites	Med
Fuses	Low