

Gas line facts, reality — and a little politics



House Majority Caucus

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Project update

- Open seasons closed 6 months and 4 months ago
- Bids were conditional (and confidential)
 - *Possible conditions: Construction delays, overruns, service interruptions, additional revenues, Alberta terminus, back-out deadline — it's not only the state*
- Complex commercial negotiations are under way
- No FERC deadline to conclude open seasons
 - *Terms become public when 'precedent agreements' ready*
- Full precedent agreements may not be public

People are working

- APP sent 19 employees and contractors to recent meeting with FERC and federal permit agencies
- APP planning three dozen open houses in 2011; its first resource reports due to FERC in 2011
- FERC has a 14-member team assigned to project
- Federal pipeline safety office, BLM, Army Corps and other agencies fully engaged in project
- Applicants are cautious about overspending until they see some results from open seasons

Shippers pay the bills

- ❑ Missed 'deadlines' for precedent agreements are not surprising, considering issues at stake
- ❑ Shippers generally take on project development financial risk with signed precedent agreements
- ❑ Alaskans need to remember producers take the commodity risk, pay the taxes and royalties
- ❑ Project needs creditworthy, ship-or-pay, long-term shippers more than it needs pipeline partners

Managing risk

- ❑ LNG import terminal developers spent \$9 billion on new or expanded terminals for U.S. markets
- ❑ Long-term capacity contracts shield them from risk
- ❑ Shippers pay if they don't use contracted capacity
- ❑ Terminal owners still on the hook for some of the risk
- ❑ Several are seeking federal approval to add LNG export capacity — to play both markets
- ❑ Alaska line can't reverse course like an LNG terminal

The unknowns

- ❑ How much will economy recover and demand build?
- ❑ How much will EPA limit greenhouse gas emissions?
- ❑ How much will utilities switch from coal to gas?
- ❑ How much will the federal government, states and municipalities constrain shale production?
- ❑ Will shale production costs rise (water handling)?
- ❑ Can Alaska gas compete on price with shale?
- ❑ What will be the price for gas 2020, 2030, 2040?

What it will take for Alaska

- ❑ Greenhouse gas restrictions, new air quality rules must continue driving utilities from coal to gas
- ❑ Gas prices rebound as demand builds
- ❑ Community resistance makes life harder on shale; water quality issues drive up shale drilling costs
- ❑ Producers see market opportunity after 2020
- ❑ Alaska gas must be competitively priced to win market share; not a penny more than others

The economics are tight

- Oil transportation costs (pipeline and tanker) eat up less than 10% of value of \$80/barrel
- Gas treatment and pipeline costs could consume two-thirds — or more — of \$6/mcf gas
- Gas shippers have to sign \$100+ billion in binding contracts (tariff) to underpin pipeline financing
- Less risk: 10 \$4 billion projects vs. 1 \$40 billion line
- State fiscal demands must take into account project risks; competition for investment dollars

Loan guarantee politics

- Increase in federal guarantee will be difficult; Congress (and the public) skeptical of helping big borrowers, bigger business, biggest banks
- Guarantee authorization easier than appropriation
- Treasury and Department of Energy will 'score' the risk of loan default and assign percentage
- Congress may be asked to pay the risk fee
- \$30 billion guarantee: 1% risk = \$300 million fee, but if the risk is judged at 5% = \$1.5 billion fee

Getting the most for Alaska

- Growing interest in a state-subsidized, small line from Prudhoe Bay to Fairbanks to Southcentral
- Hypothetical: For a multibillion-dollar state subsidy in a small in-state gas line, Alaska could get:
 - ***Gas to Fairbanks, and also gas to Southcentral
(but with a state subsidy just to match today's prices)***
 - ***Few hundred million dollars a year in taxes & royalties***
 - ***Too small of a gas volume to justify new North Slope development that could stem decline in oil production***

There is a better option

- Take those billions, negotiate and look at what could be done to help a large line to North America
- Merge the mainline and in-state pipeline projects
- The state could get for its money:
 - ***The lowest-cost gas for in-state consumers***
 - ***Tens of billions in taxes and royalties over life of project***
 - ***Moving so much gas would start an immediate push for new exploration to keep the line full for decades***

The LNG competition

- Qatar in December celebrated reaching its goal: 11 bcf/d of LNG capacity — world's largest
- \$200 billion of Australian LNG projects are under construction or under development
- Papua New Guinea to join LNG club in 2014
- Shell looking to bring first floating 'platform' online 2016 offshore Australia; \$5 billion investment
- Russia: Can't sell communism, so it's selling LNG

Not everyone loves shale

- ❑ Fracking becoming about as popular as an oil spill
- ❑ More questions as it moves closer to urban areas
- ❑ Hydraulic fracturing for shale gas requires
2 million to 5 million gallons of water per well
- ❑ Produced water disposal is the biggest issue
- ❑ Utilities official: “Environmental costs always go up.”
- ❑ Interior Department looking at new rules for
hydraulic fracturing for gas on public lands

More shale headlines

- New York governor, Pittsburgh city council, Fort Worth school board, Ohio townships and Pennsylvania communities have delayed, banned or are considering bans on shale gas drilling
- Poll: 79% Pennsylvanians concerned about fracking
- Marcellus Environmental Fund gets \$1 million
- Pennsylvania may allow local impact fees on drilling
- West Virginia looking at big boost in drilling fees

Shale could help Alaska

- Shale could help by eliminating price spikes and getting utilities to think gas for the long term
- Worldwatch Institute report: “Price volatility remains the Achilles’ heel of natural gas.”
- No utility can afford repeat of \$14 price spikes
- Utility president: “Building a 1,000-megawatt, gas-fired plant doesn't make sense if you can't be sure what your fuel costs will be.”
- Stable gas supply encourages more consumption

Utilities are thinking gas

- Clean Air Act is pushing utilities toward gas;
EPA issued new regulations Jan. 2, more to come
- President's clean-energy initiative includes gas
- Interstate Natural Gas Association of America:
Replacing half of oldest, least-efficient coal plants would boost demand 5.5 bcf per day
- Denver to go coal-free; TVA, Calpine, Xcel Energy, Constellation, Duke planning gas-fired plants

Coal may not be king forever

- Half of the nation's coal-fired electrical generating plants are more than 40 years old
- Coal-fired capacity unchanged 1997 to 2008
- No new coal-fired power plants started 2009-2010
- Credit Suisse: Just 25% of coal-fired capacity fully scrubbed; \$40 billion to scrub half of the rest
- Utilities see more federal air quality regulations, but don't know what or when — they're nervous

Local reality

- ❑ Alaska really needs the big gas pipeline project
- ❑ For the public revenues, for the jobs, for the gas, but mostly to bring in oil and gas investments
- ❑ Alaska isn't as attractive as an oil-only investment
- ❑ It's hard to justify investment dollars without a way to convert natural gas into profits
- ❑ It would be a mistake to count the 'fairness' of any gas line fiscal structure in tax dollars only

Thank you

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