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Moving for resolution for Interior gas

AIDEA project for Fairbanks energy supply is progressing on multiple fronts towards decision point over potential solution

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The Interior Energy Project, an Alaska Industrial Development and Export Authority initiative to bring affordable natural gas to Fairbanks and the Alaska Interior, is moving forward on multiple fronts, the AIDEA board heard during its monthly meeting on April 30. Members of the project team described progress in three distinct but related areas: the establishment of a suitable gas supply; the identification of private entities for the transportation of natural gas to Fairbanks; and the due diligence required for a final decision over the AIDEA purchase of Pentex Alaska Natural Gas Co. LLC, the company that currently supplies some natural gas to Fairbanks.

Meantime, work is moving ahead on the buildout of the gas distribution pipeline network in Fairbanks, on the assumption that an expanded gas supply for the city will be forthcoming.

Gas price target

Mark Gardiner from the Western Financial Group said that projected financials for the project indicate an eventual consumer gas price of \$15.89 per thousand cubic feet, assuming that an appropriate new gas supply can be established, and also assuming that the Fairbanks utility gas business expands, with Fairbanks consumers converting to the use of gas for heating their homes and businesses. A target “burner tip” price for Fairbanks gas has previously been set at \$15 per thousand cubic feet.

The Interior Energy Project originally planned on obtaining gas for Fairbanks via a to-be-constructed liquefied natural gas plant on the North Slope, with the LNG being carried by tanker truck down the Dalton Highway to the city. In early January, following months of investigation AIDEA terminated the project. The estimated cost of gas at the city gate for this project turned out to be around \$13.50. Factoring in the additional costs of Fairbanks LNG storage, LNG gasification and gas distribution around the city would have resulted in a burner tip price that would have been too high.

Now, while the option of obtaining natural gas from the North Slope has not been entirely dismissed, the AIDEA team is particularly focusing on obtaining gas for Fairbanks from the Cook Inlet basin, especially given the recent revival of the Cook Inlet gas industry. Fairbanks Natural Gas already supplies a relatively small volume of Cook Inlet natural gas to a few consumers in Fairbanks, using an LNG plant near Point Mackenzie on the inlet. But the price of this gas in Fairbanks is far above that \$15 target.

Fairbanks, with a heavy dependence on expensive fuel oil and diesel for its energy supplies, is hurting from high energy costs. And the widespread use of wood burning stoves to alleviate those costs is causing severe air pollution during the winter.

Seeking a gas supply

The Alaska Department of Commerce, Community and Economic Development, AIDEA's parent agency, is taking a lead role in trying to establish a reliable and affordable natural gas supply from one or more Cook Inlet gas producers. Robert Shefchik, AIDEA's team leader for the Interior Energy Project, told the AIDEA board that the department will issue a solicitation for gas supplies and enter into negotiations to the point of near commercial terms, with the ultimate objective of the Fairbanks utilities signing up for supply contracts.

In parallel, the AIDEA team is preparing a request for proposal for one or more private businesses for delivering the gas to Fairbanks. The RFP should go out during the week of May 15 and will remain open for 30 days, Shefchik said. The team will consider any workable option for gas delivery, including the shipment of LNG, the construction of a gas pipeline, or even the delivery of propane rather than natural gas, he said. A two-step process will then winnow down some 18 entities that have expressed an interest in the project to perhaps two or three contenders who have the capacity and interest for more comprehensive negotiations - the idea is to delineate the entire supply chain to Fairbanks, using either a single company or perhaps with different businesses handling different components of the operation, Shefchik said.

During AIDEA's June board meeting the team should be able to tell the board how many entities have responded to the RFP, what options the team is evaluating and what the timeline looks like for a decision, he said.

Pentex due diligence

Following an agreement in late January for the potential purchase of Pentex, AIDEA has been conducting its due diligence for the proposed deal. Pentex owns gas utility Fairbanks Natural

Gas, the Port Mackenzie LNG plant and the associated LNG trucking operation that currently delivers LNG to Fairbanks. However, prior to the deal with AIDEA, Pentex had announced the proposed sale of the LNG plant and trucking operation to Harvest Alaska, a subsidiary of Hilcorp Alaska, a major Cook Inlet natural gas producer.

AIDEA has said that it expects the deal with Harvest to complete, regardless of the state agency's purchase of Pentex, and that AIDEA's interest in Pentex is the acquisition of Fairbanks Natural Gas as a means of furthering the objectives of the Interior Energy Project.

Ted Leonard, the recently retired AIDEA executive director who is working with the Interior Energy Project team, told the board that the due diligence for the Pentex deal should be completed soon.

"We believe that we will be tying up the due diligence in the next one to two weeks, and be able to have a plan to the board in mid-May, for the board to be able to make a decision," Leonard said.

Gas pricing

In conjunction with the sale of the Pentex LNG assets to Harvest, Fairbanks Natural Gas has formed a 10-year natural gas supply agreement with Hilcorp, an agreement that AIDEA says will remain in place after AIDEA's Pentex takeover. Gardiner told the AIDEA board that this supply agreement involves an initial city gate price of \$15 per thousand cubic feet, with a price escalator after two years but with the possibility of negotiating a lower price after the fifth year. The gas supplied under this agreement would only amount to 0.85 billion to 0.95 billion cubic feet per year, the volume required to meet the demand of Fairbanks Natural Gas' existing customers, Gardiner said.

The Interior Energy Project concept involves a significantly larger gas demand than this, with the Fairbanks gas utilities making major expansions to their distribution networks and electric utility Golden Valley Electric Association also planning to use gas for power generation. The AIDEA project team anticipates this additional gas being purchased at a lower price than that in the existing Hilcorp deal with Fairbanks Natural Gas. The blending of the prices between a relatively small volume of gas at the higher price with a much larger volume of lower-priced gas will ultimately enable the Fairbanks gas price goal to be met, Gardiner said.

Part of the economic equation involves AIDEA's intent to merge the two existing Fairbanks gas utilities, Fairbanks Natural Gas and the Interior Gas Utility, into a single entity, once the agency has ownership of Fairbanks Natural Gas. The consolidated utility could achieve cost savings through unified management and the efficient integration of the gas storage and distribution infrastructure, AIDEA thinks. In addition, following the purchase of Fairbanks Natural Gas, consumer gas rates should drop by about 14 percent, Leonard said - AIDEA, as owner of the gas utility, would have a lower business expense profile than that of a privately owned utility.

Anticipated schedule

Gardiner said that the target closing date for AIDEA's Pentex purchase is July 31, with the sale of the Pentex LNG assets to Harvest expected to complete in September. The Interior Energy Project team then hopes to agree with stakeholders by the end of this year on a plan for Fairbanks utility consolidation. The intent is to complete that consolidation by December 2016 - AIDEA's preferred option is to sell the consolidated utility to a third party, although leasing the utility to a third-party operator is also a possibility.

The July purchase of Pentex would cost \$54 million, but with \$15.15 million of that coming back later from the sale of the LNG assets. AIDEA anticipates then recovering the resulting total cost of \$38.85 million for Fairbanks Natural Gas from the sale of the consolidated utilities in 2017, while also making a roughly \$2.9 million return on the investment, Gardiner said.

A projection of the financing of this plan indicates the gas rate for Fairbanks Natural Gas's existing customers dropping from some \$24 per thousand cubic feet at present to \$20 in 2016, Gardiner said. Then, as the Fairbanks distribution system expands and demand increases, with cheaper gas supply contracts kicking in, that rate should drop to \$15.89, he said.