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LNG/US: Alaska LNG project will likely become a competitive supply option for Asia after 2025

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• Following the filing of an export application for Alaska LNG, the project is likely to benefit from a special regulatory treatment with the DOE, which could facilitate its export approvals, as well as state support and financial backing.

• The unique characteristics means it will pose a competitive threat to projects on the US and Canadian West Coasts.

• Alaska will be well positioned to capture considerable upside in Asian gas demand, after 2025, but will need to secure customer commitments early on to underpin investment.

AK LNG is likely to get special regulatory treatment

In a noteworthy step for the Alaska LNG project (AK LNG), on 18 July the joint venture comprised of ExxonMobil, ConocoPhillips, BP, TransCanada and the state of Alaska officially submitted an application to the US Department of Energy (DOE) to export 2.5 Bcf/d for 30 years to both FTA and non-FTA countries. The proposed project, estimated to cost between $45 billion and $60 billion, would comprise three liquefaction trains at a terminal on the Kenai Peninsula, an 800-mile pipeline that crosses the length of the state, as well as a treatment plant located on the North Slope.

AK LNG is likely to benefit from a different regulatory process with the DOE compared to Lower 48 LNG projects, which could expedite and facilitate its export approvals. First, the project is distinct as its geographically separate supply base has no impact on Lower 48 gas supply or on Henry Hub prices. Second, the unique characteristics of the project, including its size, scope, costs, required upstream development, and project development timeline, are more significant than any LNG project in the lower 48 states. AK LNG has requested that the application should not be subject to DOE's existing order of precedence for processing non-FTA LNG export applications or any new procedures adopted as a result of DOE's proposed procedural change for processing LNG export applications (see Eurasia Group note "The overhaul of DOE's approval process will benefit more serious projects moving through the regulatory process" 30 May 2014). Although DOE has not yet clarified the exemption, it is ultimately likely that AK LNG will be granted a separate screening process.

In the meantime, it is highly probable that AK LNG could pre-file an application with FERC before the end of the year and as early as next month.

The project also benefits from strong state backing. AK LNG is the only way to unlock the vast gas resources of the North Slope, given that a pipeline to Canada or to the Lower 48 is no longer a viable outlet following the North American shale gas revolution. The project will also ensure many decades of gas for the Alaskan people at a time when reserves from the Cook Inlet are dwindling and concerns of possible gas supply shortfalls through 2014 and 2015 are rising.

Finally, it will give the state additional revenues far into the next decade.

Alaska LNG will undercut regional rivals

Upon its completion, which most likely would not occur until the mid-2020's, AK LNG will pose competitive threats to other Canadian and US west-coast export liquefaction plants, all targeting the same Asian buyers.

Both Alaska and Canada share large resources bases, are targeting roughly similar timelines, and have attracted interest from big companies. Similar to Canada's West Coast projects, Alaska LNG will face important risks of high development costs (remote gas fields and long-distance pipelines). However, there are also notable differences that will benefit Alaska over Canada. First, Alaska LNG is already granting fiscal certainty to the developers while uncertainty around Canada's LNG tax has delayed FIDs (see Eurasia Group's note LNG/CANADA: "Likely resolution of tax and First Nations issues mean that first FIDs will come in 2015" 25 April 2014). State participation in the AK LNG project, which was formalized following a head of agreement signed in January and enabling legislation in April, will mitigate fiscal risks around the project. The state of Alaska will become a 25% equity owner in the project, and royalties and taxes will be paid to the state in the form of gas rather than cash. So the state will foot 25% of project development costs in line with their equity position. Moreover, Alaskans appear willing to invest significant state money into the massive project, and the state is in a better fiscal position today with $17 billion in savings compared to $2 billion in 2002.

Second, in terms of the project's economics, AK LNG will benefit from a shorter shipping distance to Asian markets compared to any other North American LNG project. In addition, North Slope gas' high energy content better fits the need of Asian markets such as Japan, South Korea and Taiwan.

Third, unlike in British Columbia, there is likely to be minimal pushback from environmental groups and indigenous communities as local communities have been more focused on job creation. One area of potential pushback could have been pipeline construction, but the new pipeline would follow the same route as an existing TransCanada pipeline that has been protected since 1971, under the Alaska Native Claims Settlement Act (ANCSA), a federal law that settled claims from the First Nations in Alaska. Furthermore, most of the terminal's footprint has already seen industrial development.

AK LNG could also pose competitive challenges to US West Coast projects. However, the two projects in Oregon are targeting first cargoes at an earlier time frame in 2018-2020. If Oregon projects are lagging behind in securing final regulatory approvals and underpinning their volumes under long-term contracts, though, AK LNG could become a rising threat. Jordan Cove expects its final federal approval on February 2015. But both Oregon projects remain highly vulnerable to state-level environmental backlash (see Eurasia Group note "US/LNG: Despite DoE go-ahead, West Coast projects will struggle to take off" 25 March 2014). Moreover, a new study from Oregon State University found that there is a high chance of earthquake and tsunamis in the region that could ultimately pose major risks to the facilities.

Asian buyers will have to commit early despite pricing uncertainty

Because AK LNG will take longer than others to construct, LNG buyers will have to commit further in advance to underpin project financing, which could be a challenge as the global gas market is undergoing major structural changes. Eurasia Group's supply forecast suggests that supply will structurally exceed demand starting in 2016 (see Eurasia Group

GLOBAL LNG OUTLOOK: "Supply tightness will give way to a surge, fundamentally restructuring LNG markets" 10 July 2014). A key element in Asian buyers' decision-making will be the pricing of AK LNG at a time when Asian importers are challenging the old oil-indexed pricing structure of long-term LNG contracts. Although AK LNG is unlikely to start marketing its gas before 2016, buyers will want to know early on the details about the pricing formula to compare and hedge their bets with other regional options. AK LNG partners could face similar delays than BC projects if they insist on high oil indexation. In contrast, Jordan Cove will offer Hub pricing (either Henry Hub, Aeco hub, or Wyoming gas price), which could be a competitive advantage for the project.

Post-2020 global LNG demand, notably Japan, Korea and China will justify the viability of Alaska LNG, as long as costs can be contained. With its premium geographical location and low geopolitical risk, AK LNG is best positioned to capture demand from expiring long-term contracts in Japan and South Korea. The world's two largest importers will have to replace about 40.5 million tons of LNG from expiring contracts in the 2020-2025 timeframe. Meanwhile, China is likely to continue its gas supply diversification strategy in order to meet its growing use of gas (see Eurasia Group note NATURAL GAS: "The Russia-China deal will boost China's pricing leverage with LNG suppliers" 5 June 2014), including importing more LNG.
