Weak market could delay Alaska LNG project

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(This update, provided by the Kenai Peninsula Borough mayor's office, is part of an ongoing effort to help keep the public informed about the Alaska LNG project. We will provide further updates as more information is available.)

The weak global market for liquefied natural gas — years of expected oversupply and falling prices — is pushing the Alaska LNG partners to look even harder at the project's multibillion-dollar price tag and what it will take to successfully compete for customers.

"Economic headwinds are pretty tough right now," said ConocoPhillips Alaska President Joe Marushack. Refining the 2012 cost estimate of $45 billion to $65 billion will help determine if the project is financially viable, he said at a joint press conference in Anchorage Feb. 17 among partners ExxonMobil, BP, ConocoPhillips and the state of Alaska.

The economic reality of low oil and gas prices is pushing the partners to look closely at how best to put together an economically viable Alaska North Slope natural gas project, though none of the partners speculated on possible options Feb. 17.

"The elephant in the room has been for some time — what do we do in the challenging times of low oil prices and how does that impact the project?" Gov. Bill Walker said. The partners will look at whether there is "another ownership structure that makes more sense," though the governor did not offer any specifics.

The partners did, however, reaffirm at the press conference that the project will continue with its environmental and engineering work already scheduled for this year, including its planning, design and impact reports to federal regulators.

For the Kenai Peninsula, site of the proposed liquefaction plant and marine terminal in Nikiski, that likely means no change in onshore and offshore soils and water sampling and research work this year, and continued acquisition of land for the LNG plant. Last December, the partners approved a 2016 work plan not to exceed $230 million to complete preliminary engineering and design work.

That includes field and design work for the entire project, including the LNG plant in Nikiski, the 806-mile pipeline from Prudhoe Bay to Nikiski, and the gas treatment plant at Prudhoe Bay. This will be the project's fourth summer of field work.

The partners announced no changes in this year's work plan Feb. 17.

It's expected that Alaska LNG will submit its next round of draft environmental reports — called "resource reports" — to the Federal Energy Regulatory Commission in the next month or two. The final versions of the 13 reports, which could be submitted later this year, would be used as the base for preparing the federal environmental impact statement for the project.

The next step after completion of the preliminary engineering and design work would be a $1 billion to $2 billion work commitment to front-end engineering and design — called FEED — which would include state and federal permitting. That decision had been scheduled for mid-2017, but could be delayed pending the project review by the partners.

Even after a dramatic drop last year, global LNG prices have continued to fall in recent weeks, especially in Asia which is the likely destination for Alaska LNG cargoes. Analysts generally agree that weakened demand from Japan, China and South Korea, combined with new export projects coming online in Australia and the U.S. Gulf Coast, will hold down prices for several years.

Goldman Sachs Group recently cut its forecast for spot-market prices in Asia to $5.17 per million Btu this year and an even lower $4.63 next year. If accurate, those prices would be about one-quarter the record $20 earned by LNG suppliers to Asia just two years ago. Long-term contract prices linked to oil generally are less volatile than the spot market.

South Korea’s LNG imports in 2015 were down 13.5 percent from a year earlier, while China’s import volume was down 1.1 percent. Japan’s imports in January 2016 were off 14 percent from a year earlier as the country restarts some of its nuclear power reactors, improves its energy efficiency and enjoys a warmer-than-normal winter.

“Given the economic headwinds the oil and gas industry is facing today, it makes sense to explore options for the Alaska LNG project,” Marushack said. “We are working collaboratively to develop alternative approaches to commercialize North Slope gas.”

He described the preliminary engineering and design work as “a big effort to try to get some more information about what’s the total cost of the project, where we can reduce some costs, what the challenges might be.”

The project partners had spent almost $500 million through December 2015, since concept selection work started in 2012. This year’s spending will be in addition to that total.

“What we don’t want to do is have any sort of loss of momentum on this project because of the financial situation ... as a result of long-term low oil prices,” the governor said. As to the options, “it’s probably too soon to go into specifics on that,” he said.

“We will be looking at different options, different structures of how that would work,” Walker said, without providing details.

Janet Weiss, president of BP Alaska, also addressed the need to develop a project that can compete on price for customers. “The whole point here is to get to the lowest cost of supply and have a competitive project,” she said. “BP really wants to see this project; Alaska needs this project; it’s an important project in BP’s portfolio.”

Alaska is not alone in facing poor market conditions for multibillion-dollar LNG investment decisions. Not one of the 20 LNG export projects proposed for the British Columbia coast has committed to construction, with a Shell-led project at Kitimat, B.C., the most recent to announce a delay in its final investment decision.

Every project — whether Alaska, British Columbia, Russia, Mozambique or any of the other LNG export hopefuls — needs long-term customers to underpin project financing. Unfortunately for project developers, Asian buyers are delaying signing new long-term contracts amid forecasts of a growing supply glut.

“They’re being very short-term and opportunistic, and very commercial,” said Peter Coleman, chief executive officer of Woodside Petroleum, Australia’s largest oil and gas producer. “There are no new long-term contracts being signed, or very, very few,” he said in a Feb. 18 interview with Bloomberg News.

Woodside has been in the LNG business in Australia since 1989, where it is a partner in one project, operates a second project, and is a partner in a third project scheduled to start up in 2017.

In a separate interview with Reuters this week, Coleman warned: "This is not the time to be reckless at all with respect to capital deployment. And this is not the time to make bets the future is going to be rosier just simply because we hope it will be.”

The Alaska LNG project faces the same market demand and price unknowns as Woodside.

"What's not clear to me today,” Coleman said, “is are we in the middle of a fundamental structural change in the industry or is this just a short-term disruption, where we'll go back to long-term trends in a relatively short period of time. … It's with that sort of eye that we're looking at all of our investment decisions."