UNITED STATES OF AMERICA
BEFORE THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION

Case No. PU-15-788

Open letter to the PSC Commissioners:

As you know, Badlands NGLs, LLC ("Badlands") has been attempting to develop a new, in excess of $4 billion polyethylene ("PE") manufacturing facility to be built in North Dakota and, as such, requires supplies of natural gas and ethane, the latter to be used as a feedstock. Significantly, the majority of Badlands investors are North Dakotans. A copy of Governor Dalrymple's and my announcement of the project is attached to this letter.

We think it is necessary to bring the following facts to your attention in order to make sure you understand the severity of the situation in North Dakota and we would like to therefore take this opportunity to present these facts to you - all according to publicly available sources.

Certain gas industry officials have attempted to persuade North Dakota public officials that exporting ethane to Canada is an attractive concept. Regrettably, this concept has not been adequately refuted on the public record.

Let's talk about ethane. Ethane is by far the largest component of the natural gas liquids ("NGL") barrel, representing between 40% and 50% of the North Dakota NGL barrel. It has only two uses: it can be "blended" in very small quantities into a natural gas pipeline and it can be extracted and used to make ethylene/PE and ethylene oxide.

According to the Canadian Energy Research Institute ("CERI"), Western Canadian incremental ethane production may reach 350 Mb/d by 2020/2021. For a variety of reasons, no Western Canadian world scale PE cracker has either been announced or is even being discussed/planned. In fact, last June, Alliance's affiliate Aux Sable stated (in a CERI public forum) that "perhaps the next Western Canadian ethane cracker would be built in North Dakota by our friends at Badlands." The executive that made these statements is no longer employed by Aux Sable. In short, Canada has a surfeit of ethane, and transporting North Dakota ethane to Canada insures only one thing – North Dakota producers will lose money. That is, it will cost more to transport the ethane to Canada than the producers will receive for the sale of their product.

Instead of North Dakota ethane being shipped to Canada, the reverse will occur. A wave of Canadian NGL will be flow into the United States. The main natural gas pipeline outlet from North Dakota is Northern Border ("NB"). Despite the fact that NB has no BTU limit, sale of natural gas at Ventura must meet a 1067 BTU limit. For the past several years, Canadian gas coming into the U.S. on NB has had a BTU content of 1010 BTU, and North Dakota gas

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processing plants have added significant quantities of North Dakota ethane to NB, thereby raising the NB BTU content to just below Ventura BTU limits.

All North Dakota ethane that is exported from the state results in substantial "negative netbacks" to North Dakota oil and gas producers. This harms North Dakota oil and gas producers, North Dakota mineral rights and royalty owners, and North Dakota taxpayers. Badlands refers to this economic *fact* as the "Marcellus/Bakken Disparity." Marcellus oil and gas producers have entered into long term agreements to ship 300 Mb/d of ethane gas to European PE producers. The PE producers pay for ocean freight and processing. Marcellus producers therefore do not "subsidize" PE producers. In contrast, North Dakota ethane that is exported to Canada, to Chicago and to the U.S. Gulf Coast is sold to PE producers at substantial net losses to North Dakota oil and gas producers. While this might have been viewed as an objectionable but tolerable midstream/producer relationship when WTI prices were at or above $100/bbl., in the current environment "win/lose" midstream/producer contracts are *per se* improper and unsustainable.

During calendar year 2015, ONEOK North Dakota gas processing facilities transitioned from their historical practice of "rejecting" maximum ethane into NB (resulting in positive netbacks to North Dakota oil and gas producers) to an operating mode of extracting maximum ethane and shipping this ethane to the U.S. Gulf Coast (by pipeline) at significant "netback" loss to North Dakota oil and gas producers. Despite this major effort by ONEOK to lessen the BTU content of NB, NB BTU content *has remained fairly constant during 2015.* During this timeframe, the BTU content of gas in NB at the U.S. border has increased from 1010 to 1030 as it contains increasing amounts of Canadian ethane.

A single world scale ethylene cracker/PE facility has a capital cost in excess of $4 billion and consumes 95 Mb/d of ethane gas feedstock. Therefore, it will require almost *4 new world scale PE facilities* (costing in excess of $16 billion) to process the forecast 2020/2021 Western Canadian incremental ethane supply. Badlands continues to discuss importing significant quantities of Canadian ethane to North Dakota for its planned world scale PE facility. Initially, Canadian suppliers proposed supplying 50 Mb/d of Canadian ethane; this proposed quantity was recently revised to a proposed supply of up to 100 Mb/d of Canadian ethane. Even if Badlands were to source 100% of its ethane feedstock requirements from Canada, *incremental Canadian ethane (250 Mb/d remaining) could easily overwhelm NB's ability to continue to accept North Dakota sourced ethane gas.* Finally, if Canadian producers choose to continue to "reject" ever increasing quantities of Canadian ethane into NB, NB BTU limits will impose corresponding limitations on North Dakota "ethane rejection," resulting in shutting in oil and gas production dependent on NB for its gas take-away.

This all points to the monopolistic behavior of the midstream and pipeline companies that practice what we call "molecular tourism" and will inure to the detriment of oil and gas producers and North Dakota industry. Alliance Pipeline L.P. ("Alliance") picks up gas in Canada and in North Dakota and charges high fees for transportation. Significantly, it has forced all of its shippers to sign exclusive arrangements for fractionation with its own corporate affiliate, Aux Sable. The actions have effectively manipulated the market and closed it to any outsiders.

Badlands has been keeping a close eye on the proceedings at the North Dakota Public Service Commission ("PSC"), after you learned that Alliance was discriminating against North Dakota citizens, interests, and industries by granting exclusive natural gas processing rights to its corporate affiliate in another State. Any simple analysis of the facts detailed below will clearly show that the inter-relationships between affiliated North Dakota midstream entities such as Alliance and Aux Sable are part of the explanation for the Marcellus/Bakken disparity. By statute (NDCC §49-02-17), the PSC has a *duty* and a *responsibility* to urge Alliance to stop discriminating against North Dakota interests.

On February 10, 2016, you held a working session to discuss a draft letter to the Federal Energy Regulatory Commission ("FERC") to set out the PSC's support for downstream petroleum industries to be developed in North Dakota generally and Badlands position in particular in the Alliance matter currently pending at FERC involving the pipeline's exclusive processing arrangement with its affiliate.

Badlands has spent considerable time and resources contesting the Alliance matter at the FERC with *support of its litigation staff*, as evidenced by their statements to you and the shippers. The FERC litigation staff has concluded and authorized Badlands to include the following in a public filing at the PSC:

> The FERC Trial Staff believes that Badlands inability to secure access to the natural gas stream for purposes of extracting and processing the ethane may be **inconsistent with the FERC's natural gas pipeline open access interconnection/transportation rules, regulations and precedent**. The FERC Trial Staff further believes that Badlands' inability to secure access to the natural gas stream for purposes of extracting and processing the ethane may **create issues of undue discrimination and undue preference** under the Natural Gas Act. Finally, long-standing FERC precedent requires the FERC to consider the impact on competition of its actions. The FERC Trial Staff believes that the facts underlying Badlands' inability to secure access to the natural gas stream for purposes of extracting and processing the ethane may **constitute anti-competitive conduct**.

(emphasis added).

Against this backdrop, Badlands strongly encourages you to consider the following while finalizing your strategy for dealing with the outstanding FERC proceedings:

1. The FERC litigation staff has already decided that the conduct of Alliance and the exclusivity provided to Aux Sable may violate the FERC's regulations, the Natural Gas Act and constitute anti-competitive conduct.

2. After learning about the FERC litigation staff 's position, there is no valid reason for the PSC to consider suggestions from Alliance. Any such

suggestions will be self-serving and to the detriment of a downstream North Dakota petroleum industry.

3. If there is to be any hope for the development of a downstream North Dakota petroleum industry, any remedy of the Alliance matter must fix the after-effects of the exclusivity that Alliance has granted to its corporate affiliate, Aux Sable.

4. Significantly, as FERC litigation staff has alerted the PSC, there is no settlement agreement, not even a settlement in principle—not on the exclusive processing rights and not on transportation rates. Any claim to the contrary is baseless.

5. Alliance would like the transportation rates severed from the exclusivity issue because it knows that severing the matter into pieces will be counterproductive to a settlement of the exclusivity issue and detrimental to North Dakota interests. That way Alliance does not have to resolve the exclusivity issue now, but instead can draw out the litigation, forcing Badlands (and possibly the PSC) to battle the pipeline and expend lots of time and money.

6. Shippers will not benefit from severing the exclusive processing issue and settling transportation rates. The settlement would be contested by Badlands and possibly others, which could result in the FERC not approving the settlement or an appellate court overturning it. In other words, the shippers will benefit <u>most</u> from a global settlement that addresses all issues, including a remedy for the exclusive processing arrangement.

7. If the PSC letter includes a statement that the PSC is not concerned with Alliance's transportation rates, that could be construed as the PSC does not care if those issues are separated from the exclusive processing issue and individually settled. That would be tantamount to doing what Alliance wants -- to the detriment of North Dakota industry.

8. If the PSC is unclear in its support of an omnibus settlement of the Alliance matter, it is doing what Alliance wants -- to the detriment of North Dakota industry.

9. The PSC will expend much less time and resources sending a clear message to the FERC that it supports a global settlement only and one that remedies the results of improper exclusivity arrangements in favor of the development of North Dakota industry.

For all these reasons, Badlands urges the PSC to send a clear message to FERC that it wants all issues in the Alliance proceeding – both transportation rates and the exclusive processing arrangement – to be resolved by global settlement only <u>and</u> that any such settlement must protect North Dakota industry.

Sincerely,

William Jeffrey Gilliam
Chief Executive Officer
Badlands NGLs, LLC

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North Dakota
Office of the Governor

Governor Jack Dalrymple
Lt. Governor Drew Wrigley

Dalrymple, Badlands NGL Announce Largest Private Equity Project in State History

October 13, 2014

BISMARCK, ND – Governor Jack Dalrymple along with William Jeffrey Gilliam, CEO of Badlands NGL, LLC, today announced the development of a North Dakota manufacturing plant that will convert ethane, a byproduct of natural gas processing, into polyethylene which is used to make a wide variety of end-use consumer and industrial plastics.

Badlands NGL, LLC, and its partners expect to invest $4 billion to build the polyethylene manufacturing facility in North Dakota. The project will be the largest private investment in state history.

"This project is fully aligned with our goals to reduce flaring, add value to our energy resources right here in North Dakota and create diverse job opportunities across the state," Dalrymple said. "By advancing the responsible development of our energy resources and by adding value to all of our resources, the opportunities in North Dakota are boundless."

Joining Dalrymple and Gilliam for the announcement were Agriculture Commissioner Doug Goehring and Attorney General Wayne Stenehjem, both of whom serve with Dalrymple on the North Dakota Industrial Commission which regulates the state's energy industry. Sen. John Hoeven also participated in the announcement which was held at the state Capitol in Bismarck.

"The role of the Industrial Commission in helping the Badlands' project come together reflects the Commission's mission to promote oil and gas production in a manner that prevents waste and protects the rights of mineral owners," Goehring said. "When completed, this project by itself has the potential to reduce most of the flaring of natural gas in our state. That's real progress and good news for North Dakota."

The value-added manufacturing plant will tap into North Dakota's abundant supplies of liquid natural gas to source ethane. The facility will convert ethane gas to low density and high density plastics which are used to make a wide range of end products for consumers and industry. The facility will be able to produce 1.5 million metric tons of polyethylene, or 3.3 billion pounds annually, and will employ 500 highly trained people in manufacturing, marketing, administrative, safety, financial and executive positions. The project will take at least three years for full development.

"This is a good example of what we can accomplish by adding value to our energy resources," Stenehjem said. "This plant will not only help us reduce the flaring of natural gas, but it will also create new, high-paying jobs and further diversify our state economy."

Badlands intends to market the majority of the polyethylene products domestically, but product will also find its way to markets in Asia, South America and Europe. Project developers say that the plant's location in North Dakota will enable them to efficiently ship to world markets from the Pacific Northwest and from Atlantic ports.

"Badlands is proud to bring this manufacturing facility to North Dakota," Gilliam said. "We are committed to maximizing the value of Bakken ethane for producers, their midstream partners and all gas processors. This facility is the solution needed to add value to North Dakota's ethane supply and make it a commercially marketable product. In doing so, there will actually be a market advantage for North Dakota polyethylene products.

"North Dakota elected officials and agencies have provided Badlands with by far the most business-friendly and pro-development environment in the United States, Gilliam said. "We have been fortunate to attract many of North Dakota's leading business and community leaders as Badlands investors, and we continue to discuss debt and equity capital markets needs with major financial institutions."

In developing the world-class manufacturing plant, Badlands is working with two strategic partners, Tecnicas Reunidas, or "TR" (www.tecnicasreunidas.es), which is based in Madrid, Spain, as well as Vinmar Projects (www.vinmar.com/projects/) of Houston, Texas. TR, one of the largest petrochemicals and polymers contractors in the world, is completing a preliminary engineering analysis for Badlands. This work is scheduled for completion in 2014 and will include technology evaluations, engineering and planning, and final site selection.

Vinmar provides services in support of project finance for the development partners. Vinmar and Badlands have signed a mutually binding, 15-year memorandum of understanding for 100 percent of the polyethylene to be produced by the Badlands project.

Badlands NGL, LLC is a Delaware limited liability company. Principals and strategic partners of Badlands have considerable experience in development, construction and management of operations that convert natural gas liquid into polyolefin products.

For more information, contact: Jeff Zent or Jody Link at 701.328.2200.