



## Legislative Budget & Audit Committee February 12, 2015 Response to Questions from the Chair

### Request: What has taken place

*North Slope Trucking Project (Interior Energy Project, as approved with SB 23) Through fall 2014, progress appeared to be coming along, with construction of a gravel pad on the North Slope and other milestones. However, AIDEA has apparently terminated its agreement with MWH, and in mid-January, approved spending \$700,000 to evaluate other options to get gas to Fairbanks, including potentially from Cook Inlet. What went wrong with the MWH/ North Slope trucking proposal? What is the 'status' of the MWH partnership, and of the North Slope trucking proposal?*

### Work Performed Under the Concession Agreement

- Last January, the AIDEA Board chose a development team led by MWH to be the private partner for the design and construction of an LNG Plant on the North Slope.
- Under the Concession Agreement, MWH and AIDEA had to agree to important conditions precedent, such as a target construction cost for the LNG plant and the target delivered price of the LNG delivered to Fairbanks.
- Additionally, MWH undertook the obligation under the concession agreement to secure gas purchase agreements with the Interior utilities.
- One unique financial risk in the IEP LNG Plant is that it could be supplanted by the arrival of a gas pipeline built well before the end of the useful economic life of the plant.
- Another aspect of the concession agreement was that MWH would put together a team made up of the investor, the contractor and operator to design, build and operate the North Slope LNG plant.
- MWH chose TIC, and it was initially the concept that TIC would be an EPC for the project.
  - The first indicative price TIC delivered was a very high cost that was not tenable.
  - A second effort produced a more refined and more definite price, but it was still on the edge of what could be financed to achieve the goals of the IEP.

## **Termination of the Concession Agreement**

- Capital cost for large North Slope plant exceeded previous estimates and would have delivered LNG at a projected price high enough that, in conjuncture with projected distribution costs resulted in a meter price that did not meet the community's goals.
- Most of the "conditions precedent" to proceeding with the Concession Agreement were not achieved by the December 30, 2014 deadline.
- As the testimony at the December 16 AIDEA Board meeting indicated, MWH was not able to come to terms with the utilities. This was a result of the higher than expected cost and recent decrease in fuel oil costs that increased the utilities' risk of low conversions.
- AIDEA terminated the Concession Agreement on January 5, 2015.
- Termination of Concession Agreement allows AIDEA to evaluate other sources of supply.
- Trucking LNG from the North Slope may still be a viable part of the supply mix for FNSB and the Interior.
  - North Slope gas is abundant and is available through an existing contract with a known term and price.
  - The proposed Pentex transaction does not preclude any supply alternatives – either North Slope or elsewhere.

## **Request: Evolution to a Cook Inlet project**

*Explain where we are now, with AIDEA's shift in approach through January 2015. Two weeks after AIDEA decides to spend \$700,000 evaluating other options, AIDEA and the Governor announce a Letter of Intent with Pentex to purchase its Alaska assets – including Cook Inlet liquefaction, trucking, Fairbanks storage and re-gas, and the Fairbanks local gas distribution utility. How did this come about? How does it interface with AIDEA's plans to evaluate all other options? Were other private sector opportunities evaluated and given an opportunity to compete as the new approach?*

## **Termination of the Concession Agreement and Re-Evaluation**

- Under the Concession Agreement, AIDEA was working exclusively with Northern Lights Energy / MWH on the potential North Slope supply and MWH was responsible for negotiating purchase and sale agreements with the FNSB utilities.
- AIDEA and AEA have been working on the Interior Energy Project for more than two years and have developed a very detailed understanding of the community energy needs, the structure of the local utilities and the potential supply options.

- After AIDEA terminated the Concession Agreement, the authority began a thorough re-assessment of the project in order to determine a path to moving forward with alternative steps to meeting the community need for low-cost energy.
  - AIDEA was interested in exploring how it could set up a distribution system with sufficient cash flows that the bonds authorized in SB 23 could be used to finance future expansions of the distribution system.
  - Use of bonds would permit future distribution expansions without use of appropriated funds. If AIDEA purchases FNG, AIDEA would have an entity that has sufficient revenues that bonds could be used in an effective manner.
  - All of this analysis pointed to the need for lowering the costs of distribution as optimizing the build out of distribution as first steps.
  - As indicated, AIDEA's analysis was that if it acquired FNG it could:
    1. Lower the utility's cost of capital that would be passed on in lower distribution costs to consumers;
    2. Optimize the distribution systems of both FNG and IGU that are in the process of being built out;
    3. Make use bonds for future expansion;
    4. Be in a position to finance needed LNG storage that would levelize demand between summer and winter; and
    5. Expand service using FNG's existing source of gas through deployment of new storage and efficient distribution systems.

### **Decision to Begin Negotiations to Purchase Pentex**

- It is this context that AIDEA is evaluating purchasing Pentex Alaska Natural Gas, LLC
- This approach provides the opportunity for immediate and long term rate relief for FNSB customers, because:
  - AIDEA's cost of capital is considerably lower than Pentex's.
  - An AIDEA (or local publicly owned) utility is not subject to Federal income tax.
  - Certain non-cash expenses (e.g. depreciation) can be eliminated from the rate structure.
  - AIDEA's preliminary financial plan indicates that FNG 2015 rates could be reduced by ~8% from current rates and ~14% from the proposed FNG rates in the pending RCA rate case. Estimated FNG 2019 rates could be 15-20% lower.

## **Request: Details of the Cook Inlet proposal, as announced by AIDEA**

*Explain the plan for AIDEA's potential purchase of Pentex. The committee is looking for details, acknowledging this is a potential purchase and non-binding letter of intent. What will due diligence entail, what will it cost, how long will it take, and will it (and if so, how will it) consider other alternatives? What is AIDEA's long-term intention in regard to these assets? Will AIDEA be rate-regulated as a utility? What will be the regulatory consequences or requirements for your new plan?*

*Explain how AIDEA believes this approach will get lower-cost gas to Fairbanks. Why will the utilities be on board with this approach? What is AIDEA's analysis of costs based on? Plans seem to hinge on a low-cost gas supply out of Cook Inlet; where will this come from? Explain the Administrative Order the Governor issued in January calling on AIDEA and DNR to work together on a Cook Inlet gas supply for Fairbanks, and any nexus with this new energy project.*

*Will AIDEA's Cook Inlet approach impact Southcentral's gas supply, which is momentarily secure, but could easily face new threats in the future?*

*Please provide a full anticipated investment and financing plan for the new Cook Inlet project, including anticipated budgets, sources and uses of required funds, and any statutory authority or changes required to procure or utilize those funds. Please also be prepared to discuss the risk exposure to the state, or at least the potential risk factors.*

## **The Proposed Acquisition of Pentex Alaska**

- AIDEA could acquire Pentex Alaska Natural Gas, LLC under the basic terms of the LOI signed last month.
  - Pentex is a holding entity that owns Titan Alaska LNG, LLC (the Port MacKenzie LNG plant), Arctic Energy Transportation, LLC (the trucking and fuel station assets), Polar LNG, LLC (the rights to Pentex's North Slope plans), Cassini LNG Storage, LLC (the now deferred FNSB large LNG storage facility), and Fairbanks Natural Gas, LLC – which is the local natural gas distribution utility.
  - Pentex has entered into agreements to sell Titan and AET to Harvest/Hilcorp, and for FNG to purchase LNG from Harvest for 10 years. This LNG purchase agreement is subject to review by the AG and the RCA.
  - Purchase of Pentex would bring with it obligations, yet to be reviewed by AIDEA, to Harvest Alaska. AIDEA will meet contractual obligations. The

Acquisition of Pentex is expected to benefit the IEP regardless of the final outcome of any sales agreements or regulatory reviews.

- If the LNG purchase agreement passes regulatory review, it commits FNG to purchase LNG from Harvest/Hilcorp only up to the amount of current “baseline” demand – estimated at 0.95Bcf per year.
- The agreement does not cover any supplies FNG may secure to meet expansion demand beyond existing demand estimated.
- The Pentex acquisition involves acquiring a company that is currently profitable and cash flow positive, with a long operating history. The business risk of the acquisition is limited to the ordinary risks of a profitable monopoly utility.
- The due diligence process will identify any areas of risk related to legal, environmental, etc. If any such risks are identified that represent significant risk exposure to the state, AIDEA will not proceed with the transaction.

## **Regulatory Consequences**

- As a political subdivision of the state, a utility owned by the authority will not be regulated by the RCA, although AIDEA could decide to agree to such regulation; an AIDEA- owned utility would be akin to a utility owned by a borough government.
- To close on the purchase, AIDEA must obtain RCA approval for the transfer of control over FNG, a certificated utility.
- FNG is the only private sector entity currently serving Interior Alaska customers with natural gas, and it has the RCA-granted certificate rights to provide the core Fairbanks area with natural gas.
- The initial cost reductions customers will see will result from AIDEA’s lower cost of capital, and elimination of non-cash expenditures that are now included in FNG’s rate base.

## **Acquisition is Not Dependent on Additional Cook Inlet Natural Gas Supply for FNG**

- The rationale of acquiring Pentex and FNG is not dependent on securing a supply of lower cost natural gas from Cook Inlet or using any particular supply of gas for expanded demand.
- Nothing in the proposed Pentex/AIDEA purchase restricts AIDEA and AEA from pursuing these other supply options.
- AIDEA and AEA are continuing to evaluate all other options for LNG supplies for the Interior space heating markets – for both IGU and FNG – and for potential electric generation purposes as well.

- AIDEA will evaluate all private sector options for providing LNG needed.
- AIDEA has put together a team that will be tasked to looking for the optimal sources of gas supply.
- If Interior Alaska is supplied by Cook Inlet natural gas, AIDEA expects the relatively small demand of the Interior will not significantly impact Southcentral's gas supply.
- AIDEA's analysis has identified significant proven reserves in Cook Inlet and will continue this process as it investigates the potential of supplying the Interior with Cook Inlet natural gas.

### **Due Diligence Review of the Proposed Purchase of Pentex.**

- AIDEA's legal and financial team is in the process of gathering available information related to all Pentex assets, liabilities, operations, etc. and will also evaluate Pentex versus other, comparable companies in order to determine the final terms and conditions of a purchase, and whether the purchase is feasible.
- For external legal, financial advisor and valuation advisors, AIDEA has budgeted a total of approximately \$150,000.
- Due diligence will be completed before any financing plan is submitted to the AIDEA board for approval as required under AS 44.88.173 – currently targeted at the April AIDEA Board meeting.
- This approach focuses AIDEA's (and the State's through SB 23) low cost financing on the distribution system versus concentrating that funding of a large (over \$230mm) fixed, single source of supply from an LNG Plant.
- Since the focus of AIDEA's Pentex acquisition is on the storage and distribution system, and the Harvest/Hilcorp LNG supply agreement only covers baseline demand, AIDEA and AEA will be working with the FNSB utilities and community to secure the lowest cost, reliable supply from all potential sources. The impact of the proposed supply contract and related asset sales agreement will be evaluated as to the impact on the IEP target pricing goals.
- AIDEA's analysis of costs is based on:
  - Negotiated terms for acquisition of Pentex, and for the sale of Titan and AET to Harvest/Hilcorp.
  - FNG's historic operating costs.
  - Known FNSB capital costs for storage and distribution system expansion
  - AIDEA's internal financing costs for Development Finance projects.
  - LNG purchase costs (for the baseline demand) based on the Harvest agreement currently under RCA review.

- Estimated alternative costs for LNG purchases above the baseline demand.

### **Request: Assessment of statutory authority, required legislative policy direction, and spending authority**

*Discuss AIDEA's statutory authority, funding, and any possible legislation required to embark on the new approach. Please be clear as to AIDEA's explicit statutory authority to shift course from a North Slope trucking project to a Cook Inlet project. Please also discuss how that may interface with legislative intent. Please show, in detail, where money appropriated for the Interior Energy Project has gone, what the deliverables have been for that spend, and whether those are state or other assets. Please show what remains, explain what it statutorily can be used for, and AIDEA's intent.*

*Please provide a succinct, but detailed accounting schedule identifying dates and amounts of legislative appropriations to the SETS fund and all expenditures/loans from that fund, categorized by any restrictions that were attached to appropriations to the fund. It is only necessary to provide brief identifying descriptions for each transaction. The schedule should conclude with the amount of money remaining in the SETS fund to-date, any encumbrances, and any earmarking or restrictions on those funds.*

*A separate detailed accounting is requested for the \$57,500,000 transferred from SETS to AIDEA.*

### **AIDEA's Authority and Ability to Purchase Pentex**

- AIDEA has the statutory authority to purchase Pentex and does not need any new legislation or any new appropriation to effectuate the possible acquisition.
- AIDEA is proposing to purchase Pentex under the terms of the Letter of Intent using funds from its Economic Development Account under its powers to finance and own a project under AS 44.88.172(a).
- ADIEA in the past has used this account to invest in projects such as the Endeavor Jack-up Rig –the authority recently sold its share in the rig and received payment this week.
- However, AIDEA believes that in moving the IEP forward it would be useful to be able to use the appropriated funds for purposes other than the construction of a North Slope LNG plant or for facilities tied to the use of North Slope gas. These low cost funds could be used, for example, to finance LNG storage that could be used by FNG, IGU and GVEA. This would

be facilitated by a re-appropriation of the remaining balance of the 2013 \$57.5 million capital budget appropriation.

- Similarly, a legislative amendment of SB 23 would allow the favorable SB 23 financing terms to be utilized to finance an LNG plant at any location in the state using an economically feasible source of gas.

### **AIDEA's Statutory Authority to Continue to Make Loans for the Fairbanks Distribution System**

- One question that has been asked is whether AIDEA can continue to use SETS funds to make loans to expand the gas distribution system in Fairbanks if there is a possibility that the gas used will not come from the North Slope.
- SB 23 limits any financing AIDEA provides under the special SB 23 terms be for an LNG plant constructed in on the North Slope.
- However, no such limitation existed with regard to the legislative language regarding financing for the needed expansion of the natural gas distribution system in greater Fairbanks.
- AIDEA's proposed purchase of Pentex is to provide a cost effective means to expand this gas distribution system.
- The details of the applicable statutes and uncodified law are as follows:
  - (1) Section 11(a) of SB 23 (chap. 26, SLA 2013) does not contain an express limitation on the source of natural gas that can be used in the "natural gas distribution system and affiliated infrastructure in Interior Alaska" financed under SB 23.
  - (2) There is, in contrast, an express limitation regarding the location of an LNG plant, which is required by the legislation to be "on the North Slope." If the intent was to limit the financing of distribution system to a system only using natural gas from the North Slope, the same type of express limit seen with respect to the LNG would have been used.
  - (3) The "natural gas distribution system and affiliated infrastructure in Interior Alaska" referenced in SB 23 is intended to carry North Slope gas at some point in the future when North Slope gas is available for use.
  - (4) The IEP was always envisioned as an interim method to bring gas to the Interior until pipeline gas was available. AIDEA expects the North Slope gas to be coming either from the AK LNG pipeline project, or failing that, from the ASAP pipeline. It could also come from an LNG plant still to be developed on the North Slope by others, like GVEA for instance, which may yet involve AIDEA financing under SB 23.



- (5) For example, the Governor's Transmittal letter for SB 23 dated January 15, 2013 noted that the IEP was to allow for a wider distribution of gas so that the "distribution system will be in place for a large diameter gasline."
- (6) AIDEA Resolution No. G15-02, adopted Jan. 14, 2015, authorized the expenditure of \$500,000 from the SETS Fund and \$200,000 from the Revolving Fund to evaluate alternatives to the North Slope LNG plant.
- (7) The SETS Fund money is to be spent on professional advisors to assist AIDEA in evaluating the alternatives.
- (8) AS 44.88.680(a)(6) of the SETS statutes specifically authorizes this kind of expenditure from the SETS Fund ("contract for services with a professional advisor, including an attorney, bond counsel, engineer, or other technical expert necessary to fulfill the purposes of the program").
- (9) It should be noted that Resolution No. G15-02 authorized spending from the SETS fund, which has two sources of capitalization:
  - \$125 million –sec. 2, ch 15, SLA 2012, page 48 (SB 25 fund capitalization) of which \$57.5 was re-appropriated to AIDEA and \$50 million was re-appropriated to UAF; and
  - \$125 million-sec. 27(i), ch 14, SLA 2013, page 85
- (10) AIDEA has "old" SETS Fund money remaining from the original capitalization of the Fund in 2012 that is sufficient to pay the \$500,000. This money is not restricted in any way, except by the SETS statutes themselves. As noted above, the SETS statutes permit the types of expenditures set forth in AIDEA Resolution No. G15-02.
- (11) The "new" SETS Fund money of \$125 million received in the re-appropriation of 2013 was not restricted as to its use, other than complying with the SETS statutes themselves. There was a condition to that appropriation, which was that the Alaska Energy Authority had to approve AIDEA making a loan of at least \$10 million to advance the use of North Slope natural gas in the Fairbanks area. (Sec. 27(i), chap. 14, SLA 2013).
- (12) AIDEA made loans in excess of \$10 million to FNG and IGU to develop their distribution systems and, in compliance with the statute, AEA approved the loans.
- (13) As noted, these systems can use North Slope gas in the future, and they advance the use of North Slope by creating facilities for the use of North Slope gas that were not in existence previously.
- (14) The satisfaction of the condition to the appropriation means the money appropriated was validly transmitted to AIDEA for use under the SETS program. The condition does not become "unsatisfied" because the expected timing of getting North Slope gas to these distributions systems is changed.

- (15) AIDEA is able to use both the “old” SETS money and the “new” SETS money in any manner authorized by the SETS statutes. Development of the Fairbanks gas distribution systems qualifies for financing under the SETS program because it is a “qualified energy development.”
- (16) AIDEA’s use of the remaining balance of the 2013 \$57.5 million capital budget appropriation is restricted to purposes that advance the use of North Slope gas for a liquefied natural gas production and distribution system. AIDEA believes the development of the Fairbanks distribution system complies with this restriction. However, at the present time, AIDEA is not expending the remainder of the capital budget appropriation for the Fairbanks distribution system and it does not plan to use it for the Pentex acquisition.

### **AIDEA’s Remaining Funds for the Interior Energy Project**

- SB 23 authorized AIDEA to utilize up to \$275 million of SETS financing to advance the Interior Energy Project. Remaining SB 23 financing available for the IEP is \$222.22 million. See Schedule B for detail.
- AIDEA remaining funding sources for SB 23 Financing of \$222.22million:
  - SETS Balance, CHSHB284 Sec 2. (Original Approp.) - \$16.1 million
  - SETS Balance, CCHSHB65 Sec 27(i) (SB 23 Approp.) - \$72.2 million
  - AIDEA SETS Bonds (Bonding Authority under SB 23) - \$150.0 million
- In addition, AIDEA received a \$57.5 million capital budget appropriation for the purposes of advancing the use of North Slope for a liquefied natural gas production and distribution system.
  - \$45 million of the capital budget appropriation remain. See Schedule A for detail.
- Deliverables for money spent (see Schedule A)
  - Comprehensive demand analysis of Fairbanks Gas Requirements and analysis of price influence on conversion
  - Significant Progress on System Planning for Fairbank’s Distribution Systems
  - Distribution Build out of 33.4 miles on new pipe and financing available continued expansion (estimate approximately 98 miles)
  - Trucking and Storage Analysis (refined numbers for trucking cost from North Slope and storage cost)
  - Fully permitted and built site on North Slope for a LNG Facility
  - Advance design for a 6 BCF plant including bid quotations on major pieces of equipment leading to a value-engineering cost estimate under an EPC model
  - Operations Agreement for a North Slope Facility – Refined Operations cost - Plant Specific