

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

January 29, 2014

1:22 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Dan Saddler, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Mike Hawker  
Representative Craig Johnson  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Scott Kawasaki  
Representative Geran Tarr

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Andrew Josephson

**COMMITTEE CALENDAR**

OVERVIEW(S): ALASKA LNG PROJECT - MEMORANDUM OF UNDERSTANDING

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

JOE BALASH, Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint overview of the memorandum of understanding (MOU) between the State of Alaska and TransCanada for the Alaska Liquefied Natural Gas Project.

ANGELA RODELL, Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Assisted Commissioner Balash with his PowerPoint overview of the MOU between the State of Alaska and TransCanada for the Alaska Liquefied Natural Gas Project.

**ACTION NARRATIVE**

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**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:22 p.m. Representatives Hawker, Kawasaki, Tarr, P. Wilson, Saddler, and Feige were present at the call to order. Representatives Olson, Seaton, and Johnson arrived as the meeting was in progress. Also present was Representative Josephson.

**OVERVIEW(S): Alaska LNG Project - Memorandum of Understanding**

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CO-CHAIR FEIGE announced that the only order of business is an overview of the memorandum of understanding (MOU) between the State of Alaska and TransCanada [for the Alaska Liquefied Natural Gas (LNG) Project].

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JOE BALASH, Commissioner, Department of Natural Resources (DNR), began his PowerPoint overview by stating that on December 13, 2013, he and Commissioner Rodell of the Department of Revenue signed a memorandum of understanding with TransCanada [Alaska Company, LLC (TransCanada)] for the Alaska LNG Project. The MOU was posted online and made public at the same time, about two weeks ago, as was the Heads of Agreement (HOA). How the MOU fits into the larger construct of the HOA will be explained, as well as why he and Commissioner Rodell find pursuit of being a part of this overall project to be in the state's interest.

COMMISSIONER BALASH, to put the MOU into context, first turned to the Heads of Agreement [slide 2]. He said the project being contemplated includes a gas treatment plant (GTP), a pipeline, and a liquefaction plant, and the HOA describes how all of the parties intend to work together to advance this project through development and ultimately into construction. [The parties are State of Alaska, ExxonMobil Alaska Production, Inc., ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc.]

COMMISSIONER BALASH specified that the overall structure of the HOA contemplates an alignment of the state's production tax and royalty interests in the gas with a corresponding stake in each of the aforementioned project components [slide 3]. Each party will hold a position in each component commensurate with the party's respective interest, he explained, and each party will be free to set up its financing and partnerships as it sees fit, which is one of the challenges that the state has had historically with these companies and which was experienced under the Trans-Alaska Pipeline System (TAPS). This will preclude interfering with and complicating the business needs of the other parties, he noted.

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COMMISSIONER BALASH explained that the MOU with TransCanada covers the state's portion of the gas treatment plant and pipeline [slide 4]. Under this agreement, TransCanada will provide transportation services on the gas treatment plant and pipeline. The state's interest in the LNG plant will be held by the Alaska Gasline Development Corporation (AGDC) subsidiary contemplated in the HOA and enabling legislation [HB 277]. A reason for this is that the core competencies of TransCanada do not lend themselves to liquefaction, given that liquefaction is not a business that TransCanada is in. "It is also something that we think is going to be important for us to preserve either for ourselves or as part of our ultimate marketing efforts," he added. Continuing, he noted that the pipeline will have five offtake points that will be identified by the administration in consultation with AGDC.

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COMMISSIONER BALASH outlined the reasons for involving TransCanada [slide 5]. First, TransCanada is a preeminent pipeline company in North America with a stellar reputation for delivering projects on time and on budget. Second, the state has an aligned interest with TransCanada to have an independent pipeline operating in the state and expanding on terms that are in Alaska's interest. Third, the commercial terms underlying this arrangement provide economic benefits [to Alaska], and fourth, TransCanada has experience building in discontinuous permafrost and mountainous areas like that found between the North Slope and Nikiski. Additionally, he said, the data generated and the information gathered under the Alaska Gasline Inducement Act (AGIA) will be contributed to the Alaska LNG effort. Fifth, TransCanada's involvement will provide a

seamless transition out of the AGIA license and into this new commercial arrangement with all of the parties so that there is no impact on the overall timeline. The momentum from the current year will continue, allowing for a full summer field season in 2014 and completion of the Pre-Front-End Engineering and Design ("Pre-FEED") phase in 2015.

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REPRESENTATIVE TARR inquired whether working with TransCanada is necessary because it has the expertise or because the AGIA license with TransCanada is still in place and the State of Alaska would be exposed to a lawsuit over damages.

COMMISSIONER BALASH replied it is a combination of things. If the state were to go out cold looking for a partner to participate in the pipeline, TransCanada would be at the top of the list due to the aforementioned reasons. That is not to say that TransCanada would be a shoe-in, but TransCanada has been a partner with the state for the last six years, is familiar with the environmental and commercial conditions in Alaska, and is well acquainted with the state's interests. Thus, TransCanada does not have the same learning curve that another pipeline company might have. The existing commercial contractual relationship under the AGIA license remains in place and will wind down later this year if the legislature adopts enabling legislation. It will provide an orderly transition where the state does not face a potentially "messy divorce." Under the AGIA statute there are two paths to winding up the license, and this is the amicable one.

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CO-CHAIR FEIGE presumed the MOU is an amicable split from the AGIA process. He asked what risks would be involved if the state were to divorce TransCanada and have a bidding process to provide more competition in the selection of who would build the pipeline.

COMMISSIONER BALASH responded that this is, in many ways, a continuation or evolution of the course the state has been on. Preserving the AGIA license framework was considered and ultimately set aside, but not because of dissatisfaction with the partnership. Many of the terms contained in this MOU and attached Exhibit C are similar to the terms in the AGIA application filed by TransCanada and improved over time in the course of competition with the Denali Project. While not a

direct parallel, a footing was established in 2010 as to what an appropriate split on the debt and equity might be, as well as the returns on that equity. However, the nature of an LNG project is different and the risks associated to all the parties are different in an LNG project. Engaging in a new round of competitive bidding would require the legislature's engagement on what that framework would look like, which would take several months. Then there would be the course of going through the solicitation process, the review process, and the award process, each of which takes time. While all of that could be done, it was found during negotiation with TransCanada this past fall to be an unnecessary step because the present arrangement achieves the needed things.

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CO-CHAIR FEIGE asked how long the aforementioned process would take.

COMMISSIONER BALASH answered by citing the AGIA process: the legislature passed the statute in May 2007; the request for applications went out in July 2007; the original deadline for the applications was end of October 2007, but was pushed back to end of November 2007; and by the time the review was done and the license awarded and adopted by the legislature it was August 2008, an 18 month process. When the effective dates and the actual signing of the license in December 2008 are considered, it took nearly 24 months.

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REPRESENTATIVE KAWASAKI understood about \$300 million has been spent under the AGIA license.

COMMISSIONER BALASH said it is a little more than that.

REPRESENTATIVE KAWASAKI inquired when the legislature will see a product from the AGIA process.

COMMISSIONER BALASH responded that a number of things were done with the funds spent by TransCanada and its partners in the Alaska Pipeline Project (APP). The information gathered and generated was fed into a series of draft resource reports that were filed in 2012 with the Federal Energy Regulatory Commission (FERC), which were then sent to agencies for initial review and comment. Under the terms of the statute, the state has the option to buy out all of the data and information generated

under that process at a cost of approximately \$130 million. However, at this time, it is not being recommended that the state exercise this option, in part because TransCanada and its partners in the APP are expected to be partners in the Alaska LNG Project. They are going to contribute to the Alaska LNG Project the information gathered and avoid a duplication of effort and cost for the project being talked about today.

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COMMISSIONER BALASH turned back to his presentation, drawing attention to the definition of a typical MOU according to Investopedia.com [slide 6]:

A legal document outlining the terms and details of an agreement between parties, including each parties' requirements and responsibilities. The MOU is often the first stage in the formation of a formal contract. An MOU is far more formal than a handshake and is given weight in a court of law should one party fail to meet the obligations of the memorandum.

COMMISSIONER BALASH said the MOU for the Alaska LNG Project outlines the terms of the state's relationship with TransCanada in the midstream components of the project, which are the transmission lines coming into the gas treatment plant, the plant, and the pipeline. However, he and Commissioner Rodell cannot enter into the terms identified in the MOU and the exhibits with any force of law or binding commitment. It is specifically and explicitly spelled out that the MOU is not binding until the legislature enacts the enabling legislation. As the legislature's permission and authority are sought to enter into the various contracts associated with this project, the intent with both the MOU and the HOA is to provide a window into what the agreements will look like when they come out before 2015. This way, the public and legislators will know the intent of the parties so there can be a measure against which to evaluate the product in the fall of 2015.

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REPRESENTATIVE SEATON understood that the enabling legislation would make the terms in the MOU legally enforceable and, [if passed], would go into place this legislative session.

COMMISSIONER BALASH said that is correct.

REPRESENTATIVE SEATON said he further understood that when the MOU terms became legally binding, the state would have liabilities should things fall apart.

COMMISSIONER BALASH answered "the MOU is an agreement to agree." The term sheets in exhibits B and C are for agreements that will be struck later this year if the enabling legislation passes, and those agreements will contain the terms in these two exhibits. Under those terms, the State of Alaska will be potentially exposed to development costs incurred on the part of TransCanada during the Pre-FEED phase. The state would not be required to meet the cash calls of the project during this initial/development phase; TransCanada will be incurring those cash calls and obligations. In a success case, the state will start paying TransCanada when the pipeline goes into service. That is one of the benefits of having a partnership in the midstream as outlined with TransCanada. Also, potentially, the state may see additional partnership opportunities on the liquefaction but does not have specific partners contemplated at this time.

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REPRESENTATIVE KAWASAKI understood that if [HB 277] is not passed, the MOU will expire midsummer 2014.

COMMISSIONER BALASH responded that the authority to enter into the agreements contemplated in the MOU is the request that is being made in HB 277. If HB 277 does not pass, then this MOU [will expire].

REPRESENTATIVE KAWASAKI asked what happens if amendments are made to HB 227 that the parties have not yet agreed to.

COMMISSIONER BALASH replied by reading Article 2.1(d) on page 6 of the MOU, which states:

The Parties agree to support the approval of the Operative Terms in the Enabling Legislation, but acknowledge that the Enabling Legislation may include authorizations or conditions that vary from or conflict with the Operative Terms. In such event, and if Parties agree to accept the Enabling Legislation, then the Transition Agreements will reflect the Enabling Legislation terms and conditions notwithstanding the Parties' acknowledgement in Article 2.1(c) above.

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REPRESENTATIVE SEATON queried whether Article 2.1(d) means that passage of HB 277 would give the ability to modify the terms, and the legislature is agreeing to those terms even though it does not know what those terms will be and that those terms could be in conflict with the terms of the MOU passed by the legislature.

COMMISSIONER BALASH replied that, speaking generally to the bill, the authority being asked for is not specific to these terms; it is asking for general authority and general applicability. The intention with that authority is to enter into agreements that reflect the terms contained in this MOU and the exhibits. If that requested authority is somehow limited or conditioned by the bodies, then this section is saying that "if we are both prepared to continue to move forward under those limitations or conditions, then we will do so." He expected that all of the parties will be engaged in the legislative process and, if changes are made to the bill, each party will provide testimony reflecting its appetite to accept those conditions or further limitations. He said the parties are not the legislature, but the administration, TransCanada, and [BP, ExxonMobil, and ConocoPhillips].

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COMMISSIONER BALASH reviewed the "success case" timeline contemplated in the MOU and that fits in with the Heads of Agreement [slide 7]: enabling legislation would be passed in April 2014 and the Precedent Agreement (PA) and Equity Option Agreement in Exhibit B would be executed 90 days later [July 2014]. The Precedent Agreement would govern the Pre-FEED period with regard to development costs and associated activities. A more specific and more binding Firm Transportation Services Agreement (FTSA) would be developed, which would come back for public review and legislative approval in 2015. The expectation is that the FTSA would be a part of the larger body of other contracts necessary to enable the project to move forward and move into the Front-End Engineering and Design (FEED) stage. Until December 31, 2015, or the entry into FEED, whichever occurs first, [the state] has an option to call back a portion of its equity in the midstream.

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CO-CHAIR SADDLER inquired as to what is included in a FTSA.

COMMISSIONER BALASH said that the Firm Transportation Services Agreement is the binding contract between a transporter and a shipper for service on the pipeline. It gives the shipper a contractual right to capacity in the pipe to move gas under the terms in the contract, including the tolling structure, the capital structure for rate making, and the conditions around interruptions or delays in service. The terms are not necessarily standard. Certain features of such agreements vary from place to place or between regulatory regimes.

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COMMISSIONER BALASH, continuing his presentation, addressed Exhibit B in the MOU [slide 8], which lays out an equity callback option that has been negotiated as part of this. If the state's overall position in the project is 25 percent, TransCanada would be at 25 percent in the GTP and the pipeline, and the AGDC subsidiary would be in the LNG plant at 25 percent. However, if the state wished to exercise its option it could call back 40 percent of that midstream interest. The state would rely on the AGDC subsidiary that was established in the legislation to hold that equity interest, so then there would be a split between AGDC subsidiary and TransCanada. Using the 25 percent example, TransCanada would be at 15 percent and AGDC subsidiary would be at 10 percent. A reason for having this option is the potential revenue opportunity associated with it. That revenue opportunity, however, while real and substantial, comes at a cost of capital that the state very likely would have to bear. So, it is not a foregone conclusion that the state will want to do this; it will be part of the considerations that will be undertaken in the next 18-24 months.

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REPRESENTATIVE KAWASAKI asked what amount of cash would that 40 percent represent.

COMMISSIONER BALASH replied that the total estimate for the GTP and pipeline together is about \$22 billion. If the state was at 25 percent in the project, then the state would be looking at a total share that is about \$5.75 billion. If the state was to then take responsibility for 40 percent of that, it would be a little more than \$2 billion.

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COMMISSIONER BALASH addressed Exhibit C [slide 9], which is the term sheet for the midstream transportation services. He noted that these are the typical terms seen in a Precedent Agreement and ultimately a Firm Transportation Services Agreement. He reviewed some of the key terms and benefits that accrue to the state from this particular structure. The first key term is the state's very favorable debt to equity ratio. On the second anniversary of in-service, the tariffs charged to the state would be calculated on a 75/25 basis. The amount of leverage in the capital structure has tremendous power in driving down the tariff. Keeping tariffs low is important to the state because it results in a higher wellhead value and also lowers the hurdle to additional parties to bring in gas from beyond Prudhoe Bay and Point Thomson. It is in the state's interest to keep those terms low even if the state is one of the owners of this pipeline. Those lower tariffs improve the state's cash flows overall and that shows up on the royalty side as well as the production tax side. The second key term, said Commissioner Balash, relates to the state's exposure to cash calls during the development period. TransCanada, under its equity position, will be responsible for meeting cash calls and obligations during the development period. The state, unless it exercises its equity option, will not be responsible until gas flows. The third key term, he said, is where the Department of Revenue (DOR) becomes a much more important player in the calculus. When the opportunity cost on the state's capital is taken into consideration, the state's net present value (NPV) is improved overall by relying on TransCanada to use its cash and balance sheet. The cash requirements of the state are going to become very important over the next 10 years. Commissioner Balash related that the fourth key term continues the issues and priorities identified in the AGIA structure in that it provides a favorable expansion policy to govern the project. TransCanada has committed to structuring future expansions on a 70/30 basis, thereby providing low tariffs for expansion to shippers. Under the fifth key term, gas will be provided to Alaskans with at least five offtake points and will provide distance sensitive rates in three zones - Nenana, Big Lake, and at the LNG plant itself. This means that the largest communities in Southcentral will not pay the same tariff to get the gas connected into the ENSTAR system as the export volumes that go all the way to the plant, and the offtakes at Nenana and above will pay less in transportation cost for gas coming off the main line in that part of the state.

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REPRESENTATIVE SEATON offered his understanding that there would be no royalty or production tax impacts because the state would be taking gas in kind and that that split would be determined up front. Asking whether he is misunderstanding this, he inquired how the tariff will influence the royalty and production tax.

COMMISSIONER BALASH stated that there is confusion, and he answered by using oil as an example. When the state takes in-kind for oil on the North Slope, he explained, it does so with a price that is pegged to the Alaska North Slope (ANS) West Coast; a transportation differential is then subtracted to get to a wellhead value for that oil. The same is true for gas. A price will be achieved for the sale of the LNG, and then calculations will be worked back through the chain of infrastructure to arrive at a wellhead value for that royalty and production tax.

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REPRESENTATIVE SEATON said his understanding of the structure is that the state would take both its royalty and its tax liability in kind, thereby taking it as a percentage of gas, not a percentage of value. He asked how the tariff is going to reduce the amount of the state's gas in kind.

COMMISSIONER BALASH responded that it will not reduce the amount of gas the state gets; rather, it will impact the value the state ultimately receives for its share of the gas when the gas is sold in market. The state will take its gas at the North Slope and will be responsible for moving that gas through the infrastructure. The state will therefore need capacity in the gas treatment plant, the pipeline, and the liquefaction plant, and all of those costs will have to be accounted for. The benefit of this structure is that the state will be in control of the decisions affecting those tolls. The state will be making the decisions about the relative debt to equity ratios and the associated financing costs, rather than relying on the decisions made by the other three parties.

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REPRESENTATIVE SEATON pointed out that a big problem and dispute with oil has been the producers shifting costs to the midstream or downstream, thereby lowering the value and causing a loss in production tax to the state. He reiterated his understanding that the state will take both its royalty and its production tax

in kind as a split of the actual raw product in order to avoid a shifting of where to take the profit. He requested a flow chart showing how all of the aforementioned will work.

COMMISSIONER BALASH agreed to provide such a flow chart.

REPRESENTATIVE SEATON maintained it is a critical element if the state is not avoiding that same dispute.

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COMMISSIONER BALASH turned to slide 10, saying that it will help explain the aforementioned point but that it needs to be thought about in the context of the overall structure. He said the chart on slide 12 illustrates how a favorable debt-to-equity ratio affects the tariff. Each bar on the left side of the chart depicts a different debt-to-equity scenario for the same project cost, and the bars on the right show the changes in the return of equity (ROE). The chart shows that the same project cost, financed in different ways, results in higher or lower tariffs. The state would prefer to see a higher percentage of debt because that drives the overall tariff down. However, the state's partners are injecting and using their own equity for their portion of the project and are less concerned about the tariff, and this is where there have been tussles in the past over the TAPS tariffs, among other things. Part of the struggle over gas is how to finance this infrastructure and what the resulting tariffs will be. The four holders of gas - the state, Conoco, BP, and Exxon - all have somewhat different views as to the appropriate financing structure that will be employed in this project. The Heads of Agreement allows for each party to pursue its financing separately and independently. For example, BP can go for a split of 55 percent debt to 45 percent equity, with a resultant tariff of \$4.64 [per million British Thermal Units (MMBTUs)], if that is what works for BP. The state, on the other hand, can drop its tariff by more than 60 cents [to \$4.03] by going to a split of 75 percent debt to 25 percent equity. The freedom of this structure allows the state to pursue that higher leverage for the components that the state is invested in and shipping on.

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CO-CHAIR FEIGE understood that would be the debt-to-equity ratio on the state's share with a combined state/TransCanada share of the pipe. He further understood that the state will not have any control on the debt-to-equity ratios that the partners are

going to use, yet that will contribute into calculation of the tariff. He asked how much predictability is had here by the state.

COMMISSIONER BALASH answered that each party will be responsible for its own capacity and will have its own tariff. The tariff charged by Exxon for Exxon gas will not affect the state in tax and royalty terms. By aligning the state's interest in the infrastructure with the state's interest in the gas, the state is free to set up financing on terms that the state wants or with partners that are prepared to do it on terms that serve the state's interest.

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CO-CHAIR SADDLER, observing the chart on slide 10, inquired why the state would choose a 75 percent debt to 25 percent equity [and a resultant tariff of \$4.03 per MMBTU] when a 95 percent debt to 5 percent equity would provide an even lower tariff [of \$3.46].

COMMISSIONER BALASH replied that the "amount of skin" a party has in a major undertaking like this project really matters to the people who are lending the billions of dollars. In further response, he confirmed that this is not a "zero down" situation.

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REPRESENTATIVE SEATON, in regard to the initial spare capacity and the share each party will have of that spare capacity, asked how the tariff will be assessed and who will get that tariff.

COMMISSIONER BALASH responded that the scenario is not in any of today's forthcoming slides, but he would be happy to show the mechanics. Continuing, he said that the Heads of Agreement, Article 6 and Appendix A, contemplates that any one of the parties can expand any component in the project so long as the party does so at its sole risk. For example, if BP wants to expand but nobody else does, then BP can expand but BP must pay for the cost of the compressor station involved. The state would be unaffected - its tariff would neither go up nor down. It is expected that the state and its portion of the project are going to be providing service for third parties who show up and want to pay for service. TransCanada is prepared to undertake those expansions on a 70/30 basis, the structure of which is outlined in Exhibit C.

REPRESENTATIVE SEATON offered his understanding that if there was expansion, everybody would benefit if rates were going down. However, he is hearing Commissioner Balash say that rates will not go down because whoever expands is solely responsible, so there would not be a general lowering of tariffs among all the parties.

COMMISSIONER BALASH answered that Appendix A contemplates scenarios where capital costs, as well as equity ownership, are reallocated.

REPRESENTATIVE SEATON urged further investigation of this point because the committee's general impression was that as expansion took place the parties' tariffs would go down or, if costs were more, then only the new players would pay.

COMMISSIONER BALASH pointed out that the fight over incremental versus rolled-in pricing caused much befuddlement and was a challenge to breaking through on an overall deal. Taking the road that allows each party to set its financing and associated tariffs as it sees fit, and that allows expansions to happen on a sole-risk basis, provides an ability to maneuver around that struggle in a way that [the parties] are satisfied with.

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COMMISSIONER BALASH returned to his presentation and continued to address the favorable debt-to-equity ratio. He noted that slide 11 is another way to illustrate the benefits for Alaska and the state's tax and royalty revenues. When DNR considered the debt-to-equity ratio and the ROE during negotiations with TransCanada, the department looked at the 12 percent ROE and determined that that should be pushed down a bit. During the tug and pull of negotiation - moving down the ROE, revisiting the debt-to-equity structure - it was found that the debt-to-equity structure is far more powerful in reducing the state's tariffs and increasing the state's value, which is what is reflected in slide 11.

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CO-CHAIR SADDLER inquired whether the return on equity is determined by regulation or by market conditions.

COMMISSIONER BALASH replied that the ROE is a component of the contract and sometimes those contracts are purely commercial, purely civil, and agreed to by the two parties. But sometimes,

depending on the regulatory regime, that ROE is reviewed and approved by a rate-making body. Responding further, he said the lower the return on equity, the higher the netback, the higher the associated NPV. He confirmed that [debt-to-equity and ROE] are two different levers and [slide 11] shows the magnitude of the move with each of those levers. He further confirmed that while the chart on slide 11 shows bars for debt-to-equity and bars for ROE, there is no interplay between those two factors.

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COMMISSIONER BALASH commenced his presentation, moving to discussion of the capital that will be needed for the project's three components of gas treatment plant, pipeline, and liquefaction (slide 12). That capital will be a combination of equity, cash, and debt. He explained that each of the three scenarios depicted on slide 12 have a 20 percent equity alternative and a 25 percent equity alternative because those are the boundaries agreed to in the HOA. Under a scenario with no TransCanada participation, the State of Alaska would need to come up with about \$9.1 billion for a 20 percent equity option [\$2.7 billion in equity, \$6.4 billion in debt], or \$11.4 billion for a 25 percent equity option [\$3.4 billion in equity, \$8.0 billion in debt]. Under a scenario in which TransCanada owns the gas treatment plant and the pipeline in the state's shoes, the state's capital would be invested solely in the liquefaction plant. In this scenario, the state would provide \$4.6 billion for a 20 percent equity option [\$1.4 billion in equity, \$3.2 billion in debt], or \$5.8 billion for a 25 percent equity option [\$1.7 billion in equity, \$4.1 billion in debt]. Under a scenario in which the state exercises its 40 percent buyback, the state's capital expenditure requirements during project development would go up [\$6.9 billion for a 20 percent equity option, with \$2.1 billion in equity and \$4.8 billion in debt; \$8.6 billion for a 25 percent equity option, with \$2.6 billion in equity and \$6.0 billion debt].

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REPRESENTATIVE JOHNSON queried whether an analysis has been done for bonding at an [interest] rate of 2 percent or 3 percent.

ANGELA RODELL, Commissioner, Department of Revenue (DOR), answered that she does not think it is a good starting point to assume that the state can sell \$11 billion of debt at a 3 percent rate. This project is not going to qualify for tax exemption, she pointed out, and the aforementioned is assuming a

tax exempt rate. She further said she does not want to promise that the state can raise \$11 billion today in this market, especially at those levels.

REPRESENTATIVE JOHNSON pointed out that, in theory, the state could write that check and thereby take bonding off the table. He asked whether an analysis has been done over the life of the project at a return of 12 percent.

COMMISSIONER RODELL responded that some analysis has been done and will be presented in a forthcoming slide. Having the state write a check today to get a potential for 12 percent ROE was an option looked at. Under this option that money is not then available to do other things within the state, plus the pipeline is not expected to actually start delivering revenue until 2022. Thus, it would be a 10-year tie-up of that money. An analysis was done regarding whether there is a way that the state can account for those cash calls today, keep that money invested for the state, and use it for the state's purposes, and basically leverage the state's balance sheet. That analysis will be seen in a few slides.

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REPRESENTATIVE JOHNSON said he is trying to determine who the state should partner with and what is best for the state. Once this pipeline is built, the state is going to be "on the hook" for 20 or 25 percent of the volume should there be a failure of the pipeline for a period of time. Noting TransCanada would have bankruptcy protection, but the state would not, he inquired whether the state can contractually say that TransCanada is on the hook for its portion.

COMMISSIONER BALASH replied that exactly how the obligations are carried will be the product of negotiations between the state and TransCanada, negotiations between the state and the producers, and negotiations between the state and the buyers of the LNG. While the terms of the sales and purchase agreements (SPAs) for the LNG itself are not yet known, it can be expected that the contract the state signs with TransCanada will be used by TransCanada as a basis for financing its share of this project. The daily reservation charges that the state is going to be on the hook for, absent some other mitigation measure, will be substantial and will be measured in a couple of million dollars a day. Mitigating a risk, such as an earthquake or other disruption, is something the state must absolutely undertake to provide in this next period of development. In

some cases, companies/entities acquire insurance for those kinds of things. In regard to satisfying the obligations to buyers to continue to find and provide gas, the SPA will typically have force majeure clauses. Those kinds of things will be part of the marketing arrangements and marketing engagements undertaken in the next 18 months because that is a component for which there is not yet a firm handle. It is not yet known what the buyers are prepared to accept in the way of liability. He further pointed out that the state does not yet have any partners identified for the liquefaction. It is not unusual for buyers to want to own a piece of the liquefaction, he continued, and if that is something that the state encounters in the market place the state would certainly want to entertain that. However, the state would also want to see what part of its obligation with TransCanada would [the buyers] be prepared to take on as well.

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COMMISSIONER BALASH continued his response to Representative Johnson:

In thinking about this total approach to project ownership or equity participation in this endeavor, we did not come at this particular set of solutions with a desire to invest state capital in a pipeline project or an LNG project. The folks in the division of treasury were already doing that day in day out; they can invest in LNG projects all over the world. That is not what we are trying to do here. What we are trying to do is arrive at a point where we can see the resource monetized and potentially set up arrangements that satisfy us and our needs and result in cash flow to the state. How much risk we want to take is probably going to impact the amount of cash we get out of the resource. And one of the struggles that we have had in talking about this particular commercialization effort over the last 15 years has been the tension between RIK and RIV [royalty in value]. I would love nothing more than to sit here and stay in a position where we are at RIV, where we do not have to take any risk, and all we do is sit back and count the cash coming in when the project starts up. But, that does not appear to be a viable option for us. And as we engaged the companies in this discussion, they were pursuing an RIK solution; we were pursuing an RIV solution. And what we have

attempted to do is try to make RIK look a little more like RIV so that we are in a position to leverage the producers' expertise in marketing to get the pricing terms that would result in an RIV-like cash flow for the state. Ultimately, we may decide to pursue marketing arrangements that are different, financing arrangements that are different, and other partnerships that reduce our risk, but would probably have some impact on our cash. But it allows the other parties to make their investments and business decisions in a way that allows the project to move forward and realize this potential that Alaskans have been waiting on for 40 years. So, there is a number of ways to look at these problems and I am looking forward to solving the challenges associated with direct participation. I like puzzles. I like solving puzzles. And it so happens that Commissioner Rodell is quite adept at the financial aspects of these kinds of things. And I think we have got a great opportunity here to engage the marketplace where some of these solutions are going to be found.

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REPRESENTATIVE JOHNSON stated he likes solutions, not puzzles, but wants to make sure that all of the puzzle pieces are looked at. Recalling the statements made by Commissioner Balash that TransCanada will be going out for financing once an agreement is had and that the commissioner does not want to paint the picture that the state could go out and finance this kind of money, Representative Johnson queried whether TransCanada has a better credit rating than does the State of Alaska. Someone is going to be financing the project, and someone is going to reap the benefits of that. The question needing to be asked is whether the state is better off taking this on its own or having partners and sharing it. The state may be better off with "the four of us" doing a request for proposals (RFP). He submitted that the profits over the course of this project would far outstrip any treble damages [that the state would owe TransCanada]. He said he would like to explore the issues of whether the state would be better off cutting its losses, or better off with a partner, or better off with [TransCanada], or better off with another partner. Because this MOU is pretty specific, he said he would like the aforementioned issues to be addressed before jumping into an agreement. In order for this agreement to be a long marriage, it needs to be with the right partner. He added that he is willing to have another meeting to

discuss the aforementioned, so answers to his questions are not needed right now.

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REPRESENTATIVE TARR inquired about the point at which the state's good credit standing would be threatened by taking on too much debt. She further asked whether that credit standing, as well as how that would impact other state priorities, was part of the consideration in recommending the 75/25 ratio.

COMMISSIONER RODELL answered that two different things are going on here. First is to look at the different combinations to determine what the state can do to push the tariff low. Second, is to see the value of having a partner in this project that helps with the cash calls and the benefit of that to the state versus the risk. The risk on the rating is really one of whether the state will be able to meet its day-to-day operations as a state. If the state was to put aside \$11 billion as its equity investment into the pipeline - to make that available for cash calls when and if they are requested - creates an inability in the state's financial flexibility to meet its daily operations. There is an opportunity here to let a partner come up with the financing and to have an agreement that when the pipeline comes into use the state will start repaying those cash calls and repaying that debt. The value of not having to come up with cash over the next 10 years, and what the repayment stream looks like, is reflected in the tariff that is discussed here. If the state wants to use some cash, there are the 40 percent equity options - [in the 20 percent equity option] the state can step in and actually front-up \$6 billion rather than \$9 billion; or, in the 25 percent equity option, front-up \$8.6 billion rather than \$11.4 billion. Part of it in this case was TransCanada's willingness to give the state the option of deciding at the end of Pre-FEED whether or not to actually put up 40 percent at that time.

CO-CHAIR FEIGE commented that it is "never a good idea to get over-extended on your credit card."

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COMMISSIONER BALASH, responding to Co-Chair Saddler, confirmed that the two bars on the far left of the chart on slide 12 reflect State of Alaska ownership of the entire project at a cost of \$45 billion. In further response, he explained that the far left of the chart reflects no TransCanada involvement for

the entire project. The middle two bars reflect TransCanada stepping into the state's shoes for 100 percent ownership of the gas treatment plant and pipeline; the 20 percent and 25 percent equity is the state's share of the liquefaction facility and is the capital that the state would need to provide. Responding to a third question from Co-Chair Saddler, he confirmed that TransCanada would own 100 percent of the pipeline and treatment facility, and the State of Alaska would own 100 percent of the LNG plant and associated marine facilities.

CO-CHAIR SADDLER understood that the two bars on the far right of the chart reflect ownership by TransCanada for 100 percent of the pipeline and treatment facility, with ownership by the State of Alaska for 100 percent of the LNG plant. He requested clarification about the amount the state would buy back.

COMMISSIONER BALASH answered that the state would buy back 40 percent of the midstream, which is the equity callback option that the state has under Exhibit B.

REPRESENTATIVE JOHNSON clarified that TransCanada would own 100 percent of the state's 25 percent; TransCanada would not own 100 percent of the pipeline.

COMMISSIONER BALASH concurred.

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REPRESENTATIVE OLSON inquired whether there would be adequate information by the end of the legislative session to make a "rational vote" on the enabling legislation.

COMMISSIONER BALASH replied he has "every confidence in this institution."

REPRESENTATIVE OLSON pointed out that five of the current committee members were present "at this rodeo a few years ago."

COMMISSIONER BALASH observed that, as an institution, the committee members are far more familiar with pipeline operations and the effect of the key terms on the state. He opined that the state's and the legislature's higher point on the learning curve will enable key decisions to be made "for this step." He emphasized that it is not necessary to make a 30-year commitment today; rather, the request is for "the ability to progress this through to the next phase and stage and level of commitment by respective parties."

REPRESENTATIVE HAWKER related that his desire is to delve into the overall agreement, but said the presentation needs to be completed. He requested that there be a chance to discuss more details with the two commissioners in the near future.

CO-CHAIR FEIGE replied that there will be that chance.

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COMMISSIONER BALASH turned back to his presentation, directing attention to the chart on slide 13 depicting the State of Alaska's annual cash flows associated with the 25 percent equity alternative. He noted the blue line represents State of Alaska ownership and the state is solely responsible for the cash calls between now and project start up. When project sanction occurs in 2018, upwards of \$1.3 billion annually will be required from the state for construction. However, once start-up begins, with full ramp-up in 2023, the state's cash flow will suddenly turn positive. In 2043, he continued, the revenue begins to taper downward because the chart is depicting the proven resource at Prudhoe Bay and Point Thomson. However, the belief is that there will be additional gas resources found, and rather than revenue tapering off in 2043, the trajectory out will continue for many, many years. Commissioner Balash confirmed that the aforementioned is a highly conservative estimate and is based on the proven resources of both fields, as well as assuming an oil linkage for pricing the LNG at \$90, which is a fair bit less than is being seen in the market today.

COMMISSIONER RODELL interjected that it is important to recognize that the graphic on slide 13 does not include any additional revenues to the state that this project might produce, such as corporate income tax or property tax.

COMMISSIONER BALASH added that this estimate is to isolate the revenues that are affected with or without TransCanada.

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COMMISSIONER BALASH moved to slide 14, saying that it is another way of looking at these same issues of concern, and it takes into account the opportunity cost for the use of state capital. He explained that the chart reflects the cumulative cash flows for the three scenarios.

COMMISSIONER RODELL pointed out that this chart goes back to Representative Johnson's earlier question regarding the value of having a partner versus sole ownership. She noted the benefit for the state of not using its cash when there is participation by a partner.

COMMISSIONER BALASH addressed slide 15, which illustrates the increase in annual cash flows to the State of Alaska with an expansion of the project under the 20 and 25 percent equity alternatives. He explained that adding a train for liquefaction would require an additional train of treatment at the North Slope, and this additional throughput in the pipeline would be achieved with compression. The state's future is incredibly bright when the opportunities for continued exploration, development, and production of natural gas are considered. With the pay-off of the pipeline in 2045, the state's cash flow shoots up. Contemplated in the term sheet in Exhibit C is that at the end of the initial contract term, the state would have the opportunity to buy out TransCanada's interest in the midstream at the net book value.

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COMMISSIONER BALASH directed attention to slide 16 portraying the distance-sensitive, rate-making element for in-state deliveries. Fairbanks deliveries would be within the Nenana zone and would require a lateral from Nenana to Fairbanks with an overall tariff of \$3.70 [per MMBTU]. Tariff charges to Southcentral Alaska, the Big Lake Zone, [would be \$3.81], and charges for the full haul to the LNG plant [would be \$4.02]. He pointed out that the required treatment service, depicted in blue in the bar graph, is the same across all the delivery zones, whereas the pipeline tariff, depicted in green, varies. He concluded his presentation by expressing his excitement for the opportunity to work together and maintain momentum for this project (slide 17).

CO-CHAIR FEIGE said he is concerned about the comparative cost of severing the Alaska Gasline Inducement Act (AGIA) ties with TransCanada - a divorce from TransCanada - versus the cost of the negotiated ownership percentage with TransCanada for this project. While the reasons presented thus far seem logical, the specific numbers and the justification for the way this deal is currently negotiated, and its value to the state, need to be discussed further.

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CO-CHAIR SADDLER asked why only three offtake rates were identified when the plan is for at least five offtake points.

COMMISSIONER BALASH responded that these three offtake points could be specifically identified. However, the ultimate number of offtake points could be far more than five, and work to identify the number of offtake points will be undertaken. He explained that pre-installation, or tapping into the line during construction, is not very expensive or cumbersome to do, so there may be multiple offtake points that never get used. These three offtake points make the most sense, as they are volumetrically weighted for the largest likely draws off the pipeline.

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REPRESENTATIVE HAWKER pointed out that the committee has a due diligence responsibility to determine whether this is a good deal. "This is really kind of a take-or-leave-it deal for us," he said. "We don't have a lot of latitude." He noted that those members of the committee who "have been to this rodeo for a dozen times, have always had a lot of latitude in the process." He continued:

Here we have this necessity for enabling legislation that is specifically ... spelled out. And, in order to exit AGIA, which is necessary to go forward with another project plan here, we have to have both a trigger event and this execution of these things called transition agreements. Trigger event means the effective date of that enabling legislation, and it actually says that [TransCanada Alaska Development Inc.] finds that legislation acceptable. So, that seems to me with all respect, it is a veto authority on the whole if we make a change of sufficient merit and which is probably a material change to the enabling legislation that is pretty well clearly spelled out here in this legislation that allows you to enter into these exact terms and conditions that you are describing up here. Your partner TransCanada has the ability to say no and we just go back to square one. Which seems like ... we really are not in a certain situation here as a legislature where we have much say in the policy development.... As we look at these components, and you heard questions about debt/equity, you heard ... questions about ownership percentages and all those sort of things. How much latitude does the legislature have to get into being

proscriptive on such things without jeopardizing your agreement under this [MOU] and then subsequently the flow through to the HOA?

COMMISSIONER BALASH replied:

In terms of doing your due diligence, we are happy to play whatever role you would like us to play in that due diligence. Your contractors have made it to town. We are doing everything we can to help them understand what we looked at, how we looked at it, so that we are not talking past each other in assumptions and models, and ... will continue to do that. We looked all of this information in a variety of ways - far more than has been presented here - and we will be happy to generate whatever information we can. I would ask that we coordinate that through the respective chairmen of the committees, but ... we can present this information in any number of ways and we can look at various scenarios. With regard to the latitude of the legislature, we fully respect the independence of this body.... Again, I would call members' attention to [Article 2.1(d) of the Memorandum of Understanding].... The parties in this case - Commissioner Rodell and myself, along with TransCanada - have agreed to this set of terms and we have agreed to agree to contracts or transition agreements that look like this. But, depending upon the conditions or limitations included in the enabling legislation, they may walk. But ... that is a decision that ... they will make.... That is something that I am confident the ... process for developing legislation - there will be an opportunity for them to review whatever it is that the legislature would like them to consider and they will have an opportunity to comment on it. That is what these hearings are all about.

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REPRESENTATIVE HAWKER noted that Article 2.1(d) says "everybody agrees to support everything going forward." However, he added, the article's language also includes the word "if" and following "if" is the capitalized word "Parties". He understood Commissioner Balash to have said that "that applied to the other guys might choose to walk." Representative Hawker continued:

Capital P Parties is actually both the administration and the other guys. Is that a commitment from you that no matter what legislation passes here, the administration

will stand behind it and put the sole onus for walking away from this on the other guys?

COMMISSIONER BALASH responded that he would not characterize it that way. He continued:

Whether we are talking about this document or this document, there may be circumstances or conditions or limitations in legislation that is passed by this body where Commissioner Rodell and I are going to need to decide in our respective positions whether we think that the ... course laid out continues to be in the interest of the state.

REPRESENTATIVE HAWKER said he appreciates hearing this because he did not want to hear the commissioner abrogating his role. He added:

It is entirely possible for us to pass something that you as an administration find an inappropriate reason to go forward with the other guys, and for whatever reason they might love it....

COMMISSIONER BALASH concurred, saying, "That is a very real scenario that we contemplated."

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REPRESENTATIVE HAWKER said he would also like to discuss whether the state is really exiting AGIA in this agreement or really just temporarily suspending it.

CO-CHAIR FEIGE responded that on February 12, 2014, another hearing will be held on the MOU, where this issue can be discussed. There is an opportunity in the meantime for engagement between the commissioners and their staff and between the companies and their staff. He concurred with Representative Hawker, stating:

Whatever we end up deciding, either it falls within the ... parameters and the boundaries laid out in the MOU and the HOA or it falls outside those parameters. And if it does fall outside the parameters I would hope that neither any of the parties would simply walk away, but we would be engaged in further negotiation ... as uncertain as that may be. So, with that in mind, I ask all committee members to ... really dig down into the ... hard legal fine print on

these documents. We've got our lawyers and please converse with the co-chairs and if you have specific information for testifiers that you want to hear on this subject, or that you think would bring good outside opinions to the conversation, we will certainly work with you ... to bring that to the fore.

REPRESENTATIVE SEATON related that a general assumption is being made that the lowest possible tariffs are wanted for the state. At some point in time, he noted, the tariff could be the income stream for the state. With a low tariff the state may lose the most significant income stream that it has, depending upon the price, which would be the in-kind portion. He said he would like to have the administration provide a public discussion "of low tariff and what that gives us as future limitations on our ability to have a revenue stream depending upon the price that we get for royalty and taxes."

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#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:01 P.M.